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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BACHMANN v. ONTELL

No. 7805

Court of Chancery of the State of Delaware, New Castle

November 7, 1984

Plaintiffs brought an action pursuant to DEL. CODE ANN. tit. 8, § 225 to determine the legal composition of the board of directors of the corporation. Defendants asserted as an affirmative defense that the plaintiffs, if they are all declared to be in office so as to thereby constitute a majority of the board, intended to liquidate the corporation in a manner designed to further their own pecuniary interests. Plaintiffs motioned to strike the affirmative defense of defendants.

The court of chancery, per Vice-Chancellor Brown, granted plaintiffs' motion on the ground that the defense was an improper defense to be asserted in an action brought pursuant to section 225.

1. Corporations ⟹ 283(3)

In an action brought pursuant to DEL. CODE ANN. tit. 8, § 225, it is not a proper defense to assert that if plaintiffs are all declared to be in office so as to thereby constitute a majority of the board, they intended to liquidate the corporation in a manner designed to further their own pecuniary interests in disregard of the interests of public shareholders. DEL. CODE ANN. tit. 8, § 225 (1974).

2. Set-Off & Counterclaims ⟹ 60

In a proceeding under DEL. CODE ANN. tit. 8, § 273, dissolution of the corporate venture is the purpose of the action and thus an alleged inequitable plan or motivation in bringing the action might well constitute a matter of defense. DEL. CODE ANN. tit. 8, § 273 (1974).

Henry N. Herndon, Jr., Esquire, of Morris, James, Hitchens & Williams, Wilmington, Delaware, for plaintiffs.

A. Gilchrist Sparks III, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for defendants.

BROWN, *Chancellor*

I have decided that the motion of the plaintiffs to strike the affirmative defense of the defendants is well taken. In this action brought pursuant to 8 *Del. C.* § 225 to determine the legal composition of the board of directors of the corporation, the defendants have asserted

as an affirmative defense that the plaintiffs, if they are all declared to be in office so as to thereby constitute a majority of the board, intend to liquidate the corporation in a manner designed to further their own pecuniary interests in disregard of the interests of the public shareholders. For this reason, the defendants presumably take the position that the Court should not declare them to be directors even if it is otherwise established by the evidence that they have been properly elected and remain in office.

[1] Having reflected upon the matter, I do not view this to be a proper defense to assert in this action brought pursuant to § 225. That statute contemplates a summary proceeding, if necessary, to determine the validity of a corporate election or to determine the right of a person to hold a corporate office in the event that such office is claimed by more than one person. As such the statute is directed at the corporate election process. The affirmative defense asserted by the defendants here is not addressed to the election process, but rather it would have the Court bar the plaintiffs, or some of them, from holding office because of fiduciary improprieties that the defendants fear they are likely to commit in the event that their collective authority to serve and act as directors is established.

Such a defense is directed to the wisdom of permitting persons to act as directors of the corporation as opposed to their right, if lawfully elected under the particular corporate structure, to serve in that capacity. As such, I feel that such an affirmative defense attempts to inject into the proceeding a collateral matter which is not within the contemplation of the statute under which the summary proceeding has been brought.

[2] I think that the case of *In re Arthur Treacher's Fish & Chips*, Del. Ch., 386 A.2d 1162 (1978) is distinguishable since that was an action brought under 8 *Del. C.* § 273, a statute designed specifically to afford a swift procedure for seeking a dissolution of a joint venture corporation having only two shareholders. In a proceeding under § 273, dissolution of the corporate venture is the purpose of the action and thus an alleged inequitable plan or motivation in bringing the action might well constitute a matter of defense.

Here, however, dissolution or liquidation of the corporation is not related to the purpose of the statute. Therefore, I do not feel that the decision in *Arthur Treacher's Fish & Chips* provides any authority for offering such an affirmative defense by the defendants in this action.

At the trial I reserved ruling on the plaintiffs' motion and, for purposes of expediency, permitted defendants to offer evidence in

support of their affirmative defense subject to whatever ruling I might later make. However, since I have now decided to grant the motion, I offer this ruling in advance of any post-trial submissions so as to alert counsel that the matter of the alleged intent of the plaintiffs to liquidate the corporation to the detriment of the public shareholders is no longer in the case. Thus, there will be no need for counsel to deal with that issue in any post-trial memoranda.

The motion of the plaintiffs to strike the affirmative defense of the defendants is granted. IT IS SO ORDERED.

BACHMANN v. ONTELL
No. 7805
Court of Chancery of the State of Delaware, Sussex

November 27, 1984

In an action brought by a corporate director who resigned and four other board members against the remaining board members, the court was asked to determine the lawful composition of the board of directors.

Defendants contended that the director orally resigned at an August 14, 1984 meeting. The plaintiffs contended that a resignation by a director must be in writing to be effective under Delaware law. The court of chancery, per Chancellor Brown, found it unnecessary to rule on this issue because the preponderance of evidence in this case clearly indicated that no resignation had taken place. The court found clear evidence that defendant continued to treat the resigning director as a director following the August 14, 1984 meeting, during which the alleged resignation took place. The court held that a question of whether a director has resigned is a question of fact, and loose and ambiguous language will not be sufficient when subsequent acts are inconsistent with a resignation.

Finally, the court found that on October 29, 1984, with the resigning director present, the board held a valid meeting with plaintiff Bachmann named to replace defendant Ontell as chairman of the board.

1. Corporations ⟹ 292

The validity of a director's resignation is a question of fact and loose and ambiguous language will not be regarded as sufficient proof.

Henry N. Herndon, Jr., Esquire, of Morris, James, Hitchens & Williams, Wilmington, Delaware, for plaintiffs.

A. Gilchrist Sparks III, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for defendants.

BROWN, *Chancellor*

This is a decision after trial in a summary proceeding brought pursuant to 8 *Del. C.* § 225 to determine the lawful composition of the board of directors of Applied DNA Systems, Inc., a Delaware corporation. The key to the determination is whether the plaintiff Maurice Sussman orally resigned as a director at a meeting of the board of directors held on August 14, 1984. On the evidence presented, I find that Dr. Sussman did not resign at that meeting and that he is now, and has been at all times since August 14, a director of the corporation.

At the annual meeting of shareholders of the corporation held on June 14, 1984, nine persons, including Dr. Sussman, were elected as directors of the corporation. Dr. Sussman is aligned in his views as to corporate policy with four other directors, namely, the plaintiffs Bachmann, Deer, Demain and Kleinberg. There is no question as to the status of these four as directors. Aligned against this group in their views is the defendant Ontell, who was also President and Chairman of the Board as well as a director at the time that the events surrounding this controversy were set in motion, along with his fellow directors Hague, Nakada and Getty. Their status as directors is also not in question. In addition to being a director, Sussman also held the office of Vice President-Science and served as Chairman of the corporation's Scientific Advisory Board.

Differences had developed between Ontell and Sussman, as a result of which Ontell desired to have Sussman removed from his aforesaid offices, although he did not seek to have him removed as a director. A committee of the board was appointed to study the situation and make a report. It did so, and recommended that Sussman should be retained as Chairman of the Scientific Advisory Board but it found that it would be best if he were replaced as Vice President by someone who would be able to devote full time to the duties of the position. In addition, the report went further and recommended that Ontell be replaced as either chairman of the board or president by some

member of the board other than Sussman. This report and recommendation were presented to the board at the meeting of August 14.

At that meeting Kleinberg and Demain were absent. Thus, the Ontell faction had a 4 to 3 advantage. Neither Sussman nor Ontell participated in the vote on the committee recommendation. This reduced the advantage of the Ontell group to 3 to 2. By this margin, however, the board voted to accept the recommendation of the report as to Sussman but to reject it insofar as it recommended the removal of Dr. Ontell as either chairman or present. Thus, Sussman was removed from his position as Vice President-Research.

When Sussman and Ontell returned to the meeting and were advised of the action that had been taken, Sussman became angered, packed his papers in his briefcase, and left the meeting. The Ontell forces are clear in their minds that Sussman stated at the time that he was resigning. However, the four directors aligned with Sussman do not recall Sussman making any such unequivocal statement. Sussman denies that he resigned as a director, at that time or any other.

The plaintiffs in this action, being Sussman, Bachmann, Deer, Demain and Kleinberg, among others, take the position that as a matter of Delaware law Sussman could not have resigned on August 14 since neither at that time nor thereafter has he ever put his resignation in writing. Plaintiffs point to the language of 8 *Del. C.* § 141(b) which states that "[a]ny director may resign at any time upon written notice to the corporation." Drawing upon the decision of *Dillon v. Berg*, D. Del., 326 F. Supp. 1214 (1971) they argue that this constitutes a statutory mandate that a director must offer his resignation in a written document signed by him and delivered to the corporation in order for his resignation to be effective.

The question as to whether or not § 141(b) actually requires this has yet to be decided by a Delaware court. Were I required to rule on the point in order to decide this case, my inclination would be to hold against the plaintiffs. This is because the statutory language can be construed as permissive rather than mandatory (it is said that the purpose of this language is to provide a means for a director's resignation to become effective at his election as opposed to requiring acceptance by the corporation, which was the former status of our law) and because I can conceive of circumstances where a completely illogical result would follow from the refusal of the law to recognize an oral resignation clearly given. However, I do not have to reach the point here because even assuming that a director can resign orally, the preponderance of the evidence in this case is clearly against a finding that Dr. Sussman did so.

In the first place, of those present at the meeting, four heard Sussman resign while four others heard no such thing. Sussman himself denies that he did so. Secondly, several days following the event Dr. Ontell was given a draft of the minutes of the August 14 meeting as prepared by the plaintiff Deer, who is also corporate secretary. These draft minutes made no reference to a resignation by Sussman taking place at the meeting. Ontell specifically asked that these minutes be corrected as to two other matters, but he apparently found nothing wrong with the omission therefrom of any reference to such a significant event as the resignation of a member of the board.

Third, Dr. Ontell, still purporting to act as chairman of the board, called a meeting of the board for September 25. Notice of this meeting was sent to Sussman. Fourth, under date of August 28, Ontell sent a memorandum to the members of the board deploring the action taken at a purported August 22 meeting of the board because it was taken by only five members of the board with four members absent. Sussman was one of the five who had been present. Fifth, Ontell sent a mailgram to members of the board subsequent to the August 14 meeting. One such mailgram was addressed to Sussman.

Finally, Sussman says that he was not made aware until September 25 that Dr. Ontell and his affiliates on the board considered that he had resigned at the August 14 meeting and I recall nothing from the evidence that indicates that this issue, as such, was brought forth prior to that date. Moreover, there is no evidence that Sussman conducted himself between August 14 and September 25 as one who had resigned his post as director. Rather, his conduct was to the contrary as indicated by his attendance and participation in the purported board meeting of August 22.

[1] It is stated as a general principle at 2 Fletcher, *Cyclopedia Corporations (Perm Ed.)* § 350 that whether a director has resigned is a question of fact to be determined from the circumstances of each case and that "loose and ambiguous language will not be regarded as sufficient to prove the resignation of a corporate officer, at least where the subsequent acts and declaration of the officer are inconsistent with any such contention." In this regard, it must not be overlooked that on August 14 Dr. Sussman held three positions with the corporation—Chairman of the Scientific Advisory Board, Vice President-Research, and director. The discussion at the meeting dealt with only one of those positions, namely, Vice President-Research. Even if the defendants' version of what Sussman said is accepted—"I resign"—they are nonetheless forced to concede that he did not specify what he was resigning from.

Accordingly, I find the weight of the evidence to be against the defendants' contention that Dr. Sussman orally resigned his position as a director at the board meeting held on August 14. The finding that Sussman has continued to be a director at all times since August 14 leads to the following results.

The board meeting held on August 22, 1984 at the request of two of the plaintiff directors other than Sussman was in all probability a valid one since a majority of five directors were present. I say this despite the fact that Ontell and the three directors aligned with him contend that they were unable to attend on that date due to other commitments and that accordingly the meeting should be invalidated since there was no evidence of any reason as to why the meeting had to be held on that date as opposed to a date more convenient to all. In any event, I find it unnecessary to dwell on the meeting of August 22, because at a subsequent meeting held on October 29, which was called at the request of two directors (Bachmann and Kleinberg) pursuant to the corporate bylaws and which was duly noticed, all nine directors mentioned herein were present, and by a majority vote of the directors in attendance the actions voted upon at the August 22 meeting were ratified and re-enacted, namely, (1) the office of chairman of the board was declared vacant; (2) the plaintiff Bachmann was elected as chairman to fill the vacancy; (3) the composition of the board of directors was increased from nine to eleven; and (4) plaintiffs James Darnell and David Sherman were elected to fill the two new directorships.

Accordingly, I find from the evidence that the board of directors of Applied DNA Systems, Inc. consists of the eleven persons named herein, including Sussman, and that the plaintiff Bachmann is chairman of the board. An order commemorating this finding can be entered.

There is one thing, however, that I find troublesome. At the October 29 meeting the board, by majority vote, also "re-enacted" certain resolutions claimed to have been adopted at a board meeting held on September 25. Defendants contend that no such meeting ever took place. By plaintiffs' version this meeting took place between Kleinberg, Bachmann, Deer and Sussman (with Demain participating by telephone) immediately following the termination of an alleged meeting of the board that had been noticed by Ontell purporting to act in the capacity of chairman. (Sussman had been physically barred by Ontell from attending this meeting.) Ontell, Hague, Nakada and Getty had been in attendance along with Kleinberg, Bachmann and Deer at this alleged meeting, but plaintiffs agree that these first four did not attend the so-called "breakaway" meeting that allegedly follow-

ed the termination of the meeting called by Ontell, nor were they given notice of it.

Plaintiffs claim that on September 25 their directors quickly ducked into a vacant office following the termination of the meeting called by Ontell (which plaintiffs contend was a nullity) and held their own meeting, which was called by Bachmann on the strength of the assumption that he had replaced Ontell as chairman of the board by virtue of the meeting of August 22. Plaintiffs claim that at this impromptu meeting resolutions were adopted removing Ontell as president and replacing him with Sussman on a temporary basis, among other things. It is these resolutions which, according to the minutes of the October 29 meeting, were "re-enacted" on October 29.

I have difficulty according any credibility to this "breakaway" meeting. Aside from the fact that Mr. Hague, a director aligned with Ontell, has testified that he was on the premises at all times and that no such meeting took place, there is the fact that no notice of this meeting was given in advance and, I think it fair to say, care was deliberately taken to make sure that Ontell, Hague, Nakada and Getty did not participate. Moreover, it would be difficult for plaintiffs to rely on Ontell's notice of the meeting called by him since it is their position that Ontell was not chairman of the board at the time and therefore had no power to call the meeting in the first place.

In short, I cannot find on the evidence that this so-called September 25 "breakaway" meeting constituted valid action by the board of directors of the corporation. Since the minutes of the October 29 meeting purport only to re-enact various actions "previously taken by the Board of Directors on September 25, 1984 at a meeting presided over by Mr. Bachmann", I am unsure as to the effect, if any, to be given to these reenactments in the final order and judgment to be entered herein.

Accordingly, I feel that a meeting with counsel as to the form of order to be entered is necessary.

CAHILL v. GREEN

No. 1094

Court of Chancery of the State of Delaware, Sussex

November 8, 1984

The plaintiffs sought a temporary restraining order prohibiting transfer of shares from three of the defendant-directors to a fourth defendant. Further, plaintiffs sought to prohibit disbursement of funds from a corporate escrow account. Finally, plaintiffs sought to prevent defendant's proposed change of management of the corporate business and to prohibit defendant's plan to elect new corporate officers.

The court of chancery, per Vice-Chancellor Hartnett, stated that stockholders were free to sell their stock to any person, unless prevented from doing so by a valid stock transfer restriction on those shares. The court further held that the funds in the corporate escrow account for payment of the corporate loan were required by the court to be used for that purpose only. Lastly, defendant's plan to elect new corporate officers and to change the management of the corporate business were seen by the court as valid business judgment decisions, and in the absence of gross abuse the court refused to interfere with those decisions.

The court, therefore, denied plaintiff's application for preliminary relief except to prohibit the disbursement of the corporation's escrow account.

1. Corporations ⟹ 111, 113

The owners of stock in a Delaware corporation may sell their shares of stock to whomever they please for whatever consideration they desire unless prevented from doing so by some restriction on the transfer of the shares.

2. Corporations ⟹ 218

To permit use of corporate escrow account funds to be diverted from their intended use as payment of a corporate bank loan, on which stockholders were jointly and severally liable, could cause irreparable harm to stockholders who might be called upon to personally repay the loan.

3. Corporations ⟹ 310(1)

The management of a corporation is subject to the business judgment of a majority of the directors and, in the absence of a showing

of gross abuse, the court will not interfere in the exercise of that business judgment.

Richard F. Stokes, Esquire, of Tunnell & Raysor, Georgetown, Delaware, for plaintiffs.

William E. Wright, Esquire, of Terry, Jackson, Terry & Wright, Georgetown, Delaware, for defendants.

HARTNETT, *Vice-Chancellor*

Plaintiffs requested a temporary restraining order to enforce a purported March 3, 1984 stockholders agreement or to prevent the transfer of the ownership or control of Rose & Crown, Inc., a Delaware corporation. At the hearing on November 2, 1984, all parties were represented by counsel and therefore the application shall be treated as a motion for a preliminary injunction.

The two plaintiffs and defendants Green, Sheldon and Bauer ("the defendants") are the owners of all the stock of Rose & Crown, Inc., a Delaware corporation. Initially the plaintiffs and defendants were apparently good friends and formed the corporation to own and operate the Rose & Crown Restaurant in Lewes. Defendant Medon has agreed to purchase the shares of stock of the other three defendants. The purchase will have the effect of making Medon the majority stockholder. Defendants are also now attempting to hold a directors meeting for the purpose of electing new officers of the corporation. Neither the plaintiffs nor the defendants cited any law to the Court and therefore I will cite none.

[1] It is clear, however, that the owners of stock in a Delaware corporation may sell their shares of stock to whomever they please for whatever consideration they desire unless prevented from doing so by some restriction on the transfer of shares. The only evidence that plaintiffs presented which would indicate that there is any restriction on the transfer of shares of Rose & Crown, Inc. is a purported copy of minutes of a meeting of the corporation held on March 3, 1984. The purported minutes were apparently prepared by Shirley E. Heesters, the secretary of the corporation, who is also the wife of one of the plaintiffs. There is no evidence that a copy of the minutes was even shown to any of the defendants and at least one defendant denies that he ever saw the minutes.

The minutes, on their face, do not show that they gave rise to a valid restriction on transfer of shares. The minutes indicate that the topic of the restriction on transfer of shares was discussed at the meeting

but there is no indication in the minutes themselves that there was any agreement as to a restriction on transfer of shares. Nor is there any mechanism set forth for the handling of transfers. Nor are the minutes signed by any of the directors nor is there any indication that the minutes were ever approved by the directors. I therefore find, based on the record at this preliminary stage, that there would appear to be no valid restriction on transfer of shares of the Rose & Crown, Inc. In any event, plaintiffs have not even alleged that they would purchase the shares sold to defendant Medon if given the opportunity.

[2] Although the pleadings of the plaintiffs do not pray for the relief, the plaintiffs also, apparently, seek to prohibit defendants from disposing of the balance in a bank account of the corporation which was apparently created as an escrow to pay a loan to Mellon Bank in which the plaintiffs and defendants are jointly and severally liable. I agree that the balance in the account should be applied to the balance of the corporate loan for which the individual directors are personally liable. To permit the use of these funds to be diverted might cause irreparable harm to plaintiffs who may be called upon to personally repay the loan.

[3] Plaintiffs also apparently seek to enjoin the defendants from changing the management of the restaurant. The management of a corporation is subject to the business judgment of a majority of the directors and, in the absence of a showing of a gross abuse, this Court will not interfere in the exercise of that business judgment. No such showing has been made.

The plaintiffs also apparently object to the plan of the defendants to elect new officers of the corporation. The election of the officers of the corporation is within the discretion of the majority of the directors and the Court will ordinarily not interfere, in the absence of a showing of abuse. Plaintiffs claim that there is a prohibition on the removal of officers before their term of office is up. Defendants, although not having seen the by-laws, assert that the by-laws permit removal at any time. The Court has also not seen the by-laws and therefore can express no opinion as to whether the by-laws permit the removal of officers before completion of their term.

I also note that the purpose of a temporary restraining order or preliminary injunction is to maintain the true status quo. The true status quo in this matter is that defendants Green, Sheldon and Bauer have agreed to sell their shares of stock to another. There has been insufficient showing to cause the Court to interfere with that status quo.

I, therefore, deny plaintiffs' application for preliminary relief except to prohibit the disbursement of the corporations' escrow account.

Needless to say, the plaintiffs are likely to be left as the minority owners of a corporation in which they will no longer be part of management. This is the type of situation which often leads to protracted and expensive litigation. The parties would do well to seek to reach an accommodation among themselves.

Plaintiff may submit an order restraining expenditure of the escrow account and providing for cash bond or bond with surety in the sum of $1,000.00.

CEDE & CO. v. TECHNICOLOR, INC.

No. 7129

Court of Chancery of the State of Delaware, New Castle

October 22, 1984

Plaintiff minority shareholders of defendant Technicolor, Inc. sought an appraisal of their shares, claiming that they were eliminated from their equity positions in Technicolor through a cash-out merger. Plaintiffs sought broad discovery of the operations of Technicolor following the date of the merger and up to the present time of the suit. Technicolor protested the requested discovery on the ground that Delaware law prohibited the consideration of elements of speculative future value in the appraisal of cashed-out minority shares. Defendants further argued that the time span covering the proposed discovery would be costly and disruptive to the operation of Technicolor, and that such discovery would be unlikely to lead to the discovery of admissible evidence.

The court of chancery, per Chancellor Brown, held that the presence of a leveraged buyout necessitated a departure from general principles of discovery law and accordingly granted the plaintiffs' motion to compel discovery.

1. Corporations ⟹ 584

The remedy available to minority shareholders in a cash-out merger is an appraisal to determine the fair value of their shares, taking into account all relevant factors, excluding any elements of value arising

from the speculative accomplishment or expectation of the merger. DEL. CODE ANN. tit. 8, § 262(h) (1974).

2. Pretrial Procedure ⟹ 31, 32

Under Delaware statute, parties may obtain discovery regarding any matter, not privileged, which is relevant to the subject matter involved in the pending action, notwithstanding its inadmissibility at trial, providing that the information sought appears to be reasonably calculated to lead to the discovery of admissible evidence. DEL. CH. CT. R. 26(b)(1) (1974).

3. Corporations ⟹ 584

Dissenting minority shareholders are entitled upon appraisal to be paid the value of their proportionate share in the corporation as a going concern; in determining such value, the court should consider earning prospects and any other factors which were known or which could be ascertained as of the date of the merger and which throw light on future prospects of the merged corporation.

4. Corporations ⟹ 31, 32, 584

Under Delaware statute, any documents or information regarding the future value, earning prospects, or future prospects of corporate stock values is relevant and discoverable, provided that the plaintiffs can show that they appear reasonably calculated to lead to the discovery of evidence which would be admissible at trial. DEL. CH. CT. R. 26(b)(1) (1974).

5. Pretrial Procedure ⟹ 19, 377

Where appraisal plaintiff to cash-out merger asserts that information reasonably calculated to lead to the discovery of admissible evidence is contained in documents generated after the merger date but referring to events and results foreseeable before the date of the merger, it is within the discretion of the court to allow discovery, based upon a balancing of competing interests and other particular facts.

6. Pretrial Procedure ⟹ 28, 31, 32, 377

Even though plaintiffs seeking redress under applicable state statute may be entitled to discovery of clearly inadmissible evidentiary matter if it is likely to lead to the discovery of admissible evidence, corporate management should not be required to suffer a costly and disruptive fishing expedition by an appraisal plaintiff. DEL. CH. CT. R. 26(b)(1) (1974).

7. Pretrial Procedure ⟹ 32

Inability for appraisal plaintiff to point to specific facts reasonably calculated to lead to the discovery of admissible evidence as to the value of minority shares on the date of the merger is not fatal in the situation of a leveraged buyout where it would be inequitable to deny the shareholder qualifying for appraisal rights the opportunity to have post-merger discovery of the corporation in preparation for an appraisal hearing.

8. Pretrial Procedure ⟹ 32

In the situation of a leveraged buyout, where a person utilizes the assets of a corporation that he does not own so as to eliminate its minority shareholders, he should not be allowed to later use the discovery rules to prevent such shareholders from reasonably examining the manner in which the take-over plan was carried out.

9. Pretrial Procedure ⟹ 31, 32

Where the particular circumstances of the situation make a discovery request appear to be reasonably calculated to lead to the discovery of information from which admissible evidence as of the date of a cash-out merger could be developed, the discovered should be permitted even though the post-merger information itself would in all possibility constitute inadmissible evidence.

10. Pretrial Procedure ⟹ 25

In any case in which discovery of corporate merger records and related transactions is permitted, the time period over which it is allowed following the merger date is always a factor to be considered.

Peter M. Sieglaff, Esquire, of Potter, Anderson & Corroon, Wilmington, Delaware, for plaintiffs.

Thomas J. Alligham II, Esquire, of Skadden, Arps, Slate, Meagher & Flom, Wilmington, Delaware, for defendants.

BROWN, *Chancellor*

This is an overly-long discovery ruling in a stock appraisal action brought pursuant to 8 *Del. C.* § 262. This unfortunate development is attributable to the somewhat nebulous nature of the issue joined coupled with the fact that I was writing while I was thinking, or vice versa, as the case may be. In any event, I regret the length of the

decision, but in the current order of things I simply do not have the time to refine and condense the effort.

The petition for appraisal has been brought jointly by Cede & Co., as record owner, and by Cinerama, Inc., as the beneficial owner, of 201,200 shares of the defendant Technicolor, Inc. The defendant Technicolor has objected to the request of the plaintiffs for the production of documents and also to interrogatories served upon it by the plaintiffs. The plaintiffs have moved to compel production of the documents and to compel answers to the interrogatories pursuant to Rule 37.

The point of dispute is the scope of the discovery sought. The cash-out merger through which the plaintiffs were eliminated from their equity position in Technicolor occurred on January 24, 1983. It is conceded that plaintiffs have qualified for an appraisal of their stock under the statute and that to this end they are entitled to discovery. However, in addition to seeking discovery of information which existed as of the date of the merger, plaintiffs also seek discovery through the date of Technicolor's responses. In other words, they seek the production of documents and the disclosure of information which came into being during the course of the 20-month period which followed the effective date of the merger. While agreeing voluntarily to make available certain information through December 31, 1983, Technicolor takes the position that plaintiffs have no right to the discovery of events which occurred subsequent to the date of the merger.

[1] Requests by a plaintiff for post-merger discovery are no doubt on their way to becoming an increasingly significant problem, particularly in light of the current emphasis and interpretation placed upon the appraisal remedy by *Weinberger v. UOP, Inc.*, Del. Supr., 457 A.2d 701 (1983). The appraisal statute makes it clear at § 262(h) that in appraising the shares of a Delaware corporation this Court must determine their fair value "exclusive of any element of value arising from the accomplishment or expectation of the merger". Aside from this limitation, however, the statute requires the Court to "take into account all relevant factors" and in *Weinberger* the Supreme Court has held that the statutory category of "all relevant factors" can include practically anything other then the speculative elements of value that may arise from the expectation or accomplishment of the merger, such as may be evidenced by *pro forma* data and speculative projections premised on the completion of the merger. It has specifically held that "elements of future value . . . which are known or susceptible of proof as of the date of the merger", and which are not the product of speculation, may be considered. 457 A.2d 713.

[2] This, of course, sets the standard for that which is admissible evidence for appraisal purposes. But it does not address the extent to which "all relevant factors" are discoverable, and Chancery Rule 26(b)(1) provides that any nonprivileged matter is "relevant to the subject matter" of the pending action is discoverable, regardless of the fact that it may be inadmissible at trial, provided that the information sought "appears reasonably calculated" to lead to the discovery of admissible evidence.

[3] In *Weinberger* the Supreme Court also reaffirmed the language of *Tri-Continental v. Battye*, Del. Supr., 74 A.2d 71 (1950) which stated that the basic concept of value under the appraisal statute is that the shareholder is entitled to be paid the true or intrinsic value of his proportionate interest in the corporation as a going concern. In determining this true value the Court is to consider "earning prospects", among other things, as well as any other facts "which were known or which could be ascertained as of the date of the merger and which throw any light on future prospects of the merged corporation". 74 A.2d 72.

[4] Rearranging these principles in the context of the present application, what we have here is an appraisal action which, for discovery purposes, makes the true value of the plaintiffs' proportionate interest in Technicolor as a going concern as of the date of the merger the subject matter of the action. Under *Weinberger* and *Tri-Continental* relevant factors to be considered in determining this true value include (1) elements of *future value*, (2) *earning prospects*, and (3) any other facts which throw light on the *future prospects* of Technicolor, provided that they were either known or were capable of being ascertained as of the date of the merger. Thus, any documents or information having a bearing on any of these three factors would be relevant to the subject matter of the action for discovery purposes under Rule 26(b)(1) regardless of their inadmissibility at a trial, provided that the plaintiffs can show that they appear reasonably calculated to lead to the discovery of evidence which would be admissible at trial. The application of this latter principle provides the basis for the decision on the present motion to compel.

In this case, the cash-out merger came about as a part of a plan by MacAndrews & Forbes Group, Incorporated ("MacAndrews & Forbes") to acquire Technicolor. MacAndrews & Forbes commenced this plan in November, 1982 by means of a tender offer whereby it increased its ownership in Technicolor to some 82%. As noted previously, the merger whereby the remaining shareholders were

eliminated followed on January 24, 1983. The acquisition was accomplished through a leveraged buyout plan under which MacAndrews & Forbes pledged the assets and earnings of Technicolor in order to secure the financing for the deal and then sold off various Technicolor assets after acquiring full ownership of the company to pay down the financing debt to a level where it could be amortized by the earnings of the company as derived from its remaining business operations.

The plaintiffs' theory here in contending that they were not paid a realistic and fair price for their Technicolor shares is tied to this leveraged buyout plan through which MacAndrews & Forbes acquired Technicolor. Some background is necessary to put the matter into perspective.

Immediately prior to 1981 Technicolor engaged primarily in two separate lines of business and enjoyed considerable success. In 1981 its management made the decision to diversify and to enter into two additional market areas. These new ventures were capital intensive and initially generated only losses or inadequate profits. It is said that the stock market reaction to this caused the price of Technicolor's stock to decline substantially even though the company as a whole was apparently sound.

In October, 1982 MacAndrews & Forbes, then the owner of some 200,000 shares of Technicolor, formulated its plan to acquire the corporation. Reduced to its simplest terms, MacAndrews & Forbes obtained the necessary financing commitment with which to make its tender offer and to effectuate the follow-up, cash-out merger by agreeing with its financing sources to sell off the two new ventures, plus some possible real estate assets, once it acquired complete ownership of Technicolor. The proceeds from this planned disposition of assets were to be used to reduce the financing debt to a specified post-merger level. The basic idea was to eliminate the drain on the corporation's cash flow by disposing of the ne ventures so as to return it to its pre-1981 level of profitability which, in turn, would generate sufficient income to reasonably amortize the remaining balance on the debt incurred by MacAndrews & Forbes in making the acquisitions and still leave a profit for MacAndrews & Forbes as its sole owner.

Because this asset divestiture plan was set in place from the beginning as a part of MacAndrews & Forbes' acquisition strategy, plaintiffs take the position that since they declined to tender their shares during the tender offer they remained as fellow shareholders of Technicolor along with MacAndrews & Forbes between the time of the tender offer and the time they were involuntarily removed from

the corporation in the cash-out merger, and that as such they were entitled to share along with MacAndrews & Forbes as of the date of the merger in the anticipated and foreseeable results of this asset divestiture plan.

In essence, plaintiffs contend that the plan of MacAndrews & Forbes to acquire Technicolor through such a leveraged buyout amounted at the same time to a plan to restructure the corporation. Accordingly, it is their position that nothing that transpired after January 24, 1983 was a function or product of the accomplishment of the merger itself. Rather, they contend that anything that came about after the merger, including any increase in the value of the corporation or its shares, was the result of the leveraged buyout plan adopted in the fall of 1982, and that as shareholders who refused to tender, they have as much right as MacAndrews & Forbes to receive their share of the foreseeable fruits of that restructuring effort.

Because of this theory, and because of the fact that the various Technicolor assets were apparently sold off following the merger as planned, plaintiffs take the position that they are entitled to broad discovery of the operations of Technicolor following the date of the merger and up to the present time. They say that the anticipated post-merger sale of substantial Technicolor assets, and its realistic future prospects as a result thereof, are "elements of future value" which were reasonably foreseeable and not the product of speculation as of the date of the merger and that accordingly any information connected with the sale of those assets is discoverable, regardless of when it came into being.

Plaintiffs also point to the fact that in May, 1983, some four months after the merger, the announcement was made that MacAndrews & Forbes itself would be taken private, an event which eventually took place, 1984. Plaintiffs suggest that independent evaluations of Technicolor, as a wholly-owned subsidiary of MacAndrews & Forbes, would have been made in connection with that transaction and that any such evaluations should be produced for the purposes of this proceeding. They also seek financial projections made for Technicolor following the merger as well as evidence of its actual earnings from the date of the merger to the present time.

In short, plaintiffs contend that for discovery purposes they are entitled to follow up on the degree of success of the asset divestiture plan because in their view the discovery of documents generated and information obtained after the merger date is, at the very least, reasonably calculated to lead to the discovery of admissible evidence on the question of what elements of Technicolor's future value were

"known or susceptible of proof" as of the date of the merger. Without pointing to anything of a specific nature, they say that the circumstances of the situation make it clear that information reasonably calculated to lead to the discovery of admissible evidence as to the true or intrinsic value of Technicolor stock on January 24, 1983 is contained in documents generated after that date but which refer to events and results foreseeable before the date of the merger.

As noted previously, Technicolor has agreed to produce voluntarily certain post-merger documents. Specifically, it has agreed to produce documents and information relating to sales of assets by Technicolor through December 31, 1983, the balance of the calendar year following the merger. However, it has declined to produce any post-merger document or to supply post-merger information which is not related to asset sales on the grounds that such documents or information are irrelevant to the issue of the case and that plaintiffs have failed to show that such information is reasonable calculated to lead to the discovery of admissible evidence.

[5] The principle involved in this dispute creates an awkward procedural situation as I see it. The decision requires, I think, a balancing of competing interests. I am sympathetic with the plaintiffs' position that their right to reasonable discovery should not be arbitrarily limited to events which predated the merger and that they should not be compelled to be content with only such post-merger information as Technicolor, in its benevolence, chooses to make available. On the other hand, upon cutting through the rhetoric of their various arguments I am forced to agree with Technicolor that plaintiffs have offered no specific facts to suggest that the post-merger discovery sought by them is likely to lead to admissible evidence on the question of value. They simply rely on what Technicolor characterizes as the bland assertion that "the record makes it very clear" that information reasonably calculated to lead to the discovery of admissible evidence "is contained in documents generated after [the merger] date but referring to events and results foreseeable before the date of the merger." (Plaintiffs' Opening Brief at page 8.) However, to me the particular facts relied upon for this proposition are not necessarily indicative of any such thing.

[6] As I see it, plaintiffs' premise reduces itself to the contention that evidence of some pre-merger elements of value will necessarily be disclosed through an examination of the post-merger documents and information that they seek, and that accordingly they should be permitted to look so as to see what they can find. But Technicolor argues that such a premise will not overcome an objection to production on the grounds of relevancy under Rule 26(b)(1) since the plain-

tiffs first have the burden to show that the production or disclosure of clearly inadmissible evidentiary matter is likely to lead to the discovery of admissible evidence. It says that under the appraisal statute elements of value arising from the accomplishment of a corporate merger are not admissible evidence and that plaintiffs have offered nothing but speculation here to support their contention that the discovery of Technicolor's business operations during the 20-month period following the merger will lead to the discovery of admissible pre-merger evidence on the issue of value. To the extent that Technicolor is arguing, as I think it is, that as a general rule corporate management should not be required to suffer a costly and disruptive fishing expedition by an appraisal plaintiff under such circumstances, I can be sympathetic with its logic also.

[7] But if there is something to be said for both sides of the issue, then reason would seem to suggest that a solution should lie in some middle ground. I think that such middle ground exists in this case and I think it derives from the fact that Technicolor was acquired by MacAndrews & Forbes, and the plaintiffs eliminated from their equity position in the corporation, through the device of the leveraged buyout.

In so stating I am proceeding on the assumption that the leveraged buyout here was a true leveraged buyout as I understand the term in the corporate sense, namely, a pledge by MacAndrews & Forbes as to a particular disposition of assets which it did not own at the time in order to obtain the financing to acquire the company that did own them, and to remove and eliminate all other shareholders of that company in the process. Under such a scenario it is contemplated from the outset that by the time a dissenting shareholder can qualify for statutory appraisal rights the corporation will be wholly owned by the party who is committed in advance to taking action following the merger that will change the future structure, and thus the future prospects, of the corporation. In such a situation I think that it would be inequitable to deny the shareholder qualifying for appraisal rights the opportunity to have post-merger discovery of the corporation in preparation for his appraisal hearing simply because he could point to no specific facts as such which would indicate that the production or disclosure of post-merger business and financial information "appears reasonably calculated" to lead to the discovery of admissible evidence as to the value of his shares on the date of the merger.

[8] Stated another way, while Technicolor's position here may be arguably correct as general principle of discovery law, and perhaps

particularly so in a non-leveraged buyout setting, I do not feel that one should be permitted to enter into a plan to utilize the assets of a corporation that he does not own so as to eliminate its minority shareholders against their will and then use the discovery rules to hide behind the bar of the date of the merger to prevent such shareholders, when they are later attempting to develop admissible evidence on a valuation issue as to which they presumably have the burden of proof, from reasonably examining into the manner in which the plan was carried out. In such a circumstance elements of future value and the earnings prospects of the corporation are in the picture from the beginning and I think it is reasonable to conclude that discovery of the manner in which the plan to dispose of corporate assets following the merger was actually carried out, and the corporate fortunes resulting therefrom, as compared with the manner in which it was intended, is reasonably calculated by the very nature of the transaction to lead to the potential discovery of admissible evidence ascertainable at the time of the merger which could throw light on the future prospects of the merged corporation as of that time. At least I feel that the circumstances of the present case as they have been argued and presented warrant such a conclusion.

[9] This result, I think, is in keeping with the underlying rationale employed in the series of recent unreported decisions dealing with the discovery of post-merger information, see *Kaye v. Pantone, Inc,*, Del. Ch., C.A. No. 5466, Hartnett, V.C. (Oct. 6, 1981); *Kaye v. Pantone, Inc.*, Del. Ch., C.A. No. 5466, Hartnett, V.C. (Mar. 28, 1983); *Kahn v. Household Acquisition Corp.*, Del. Ch., C.A. No. 6293, Brown, Ch. (April 26, 1983); *Ross v. Proco Management, Inc.*, C.A. No. 6146, Hartnett, V.C. (May 23 1983), namely, that where the particular circumstances of the situation make the discovery request appear to be reasonably calculated to lead to the disclosure of information from which admissible evidence as of the date of the merger could well be developed, the discovery should be permitted even though the post-merger information itself would in all probability constitute inadmissible evidence.

[10] Of course, in any case in which such discovery is permitted the time period over which it is allowed following the merger date is always a factor to be considered. Here, the period involved is slightly more than a year and a half and under the circumstances as argued I do not find this to be an unreasonable period. Accordingly, the motion of the plaintiffs to compel discovery will be granted.

CHARLIP v. LEAR SIEGLER, INC.

No. 5178

Court of Chancery of the State of Delaware, New Castle

November 27, 1984

In this appraisal action, both parties objected to the findings of the appraiser. Plaintiffs maintained that the appraiser's valuation was inadequate and that the case should be remanded and reopened. Defendants averred that since they owned ninety percent of the stock, it had no market value and the valuation was, therefore, excessive.

The court of chancery, per Chancellor Brown, rejected arguments made by both sides in holding: (1) when a court reviews a decision made by a master or appraiser, the decision will be accepted if there is a basis for it in the evidentiary record; and (2) attorneys are entitled to enter into stipulations and make admissions for their clients.

1. Appeal and Error ⟹ 996

When a court reviews a decision of a master or an appraiser, it is not proper to ignore the appraiser's findings and review the entire evidentiary record anew.

2. Corporations ⟹ 182.4(6)

The purpose of utilizing a master or an appraiser is to assist the court in expediting its business.

3. Appeal and Error ⟹ 996

If the master or appraiser's decision is supported by the record, it should be accepted.

4. Federal Civil Procedure ⟹ 165

When plaintiffs are the only persons bringing suit, speaking only for themselves, they are not class representatives.

5. Attorney and Client ⟹ 86, 101(1)

Attorneys are permitted to enter into stipulations and admissions in the course of representing their client.

6. Corporations ⟹ 182.4(6)

An appraiser's determination of a price/earnings ratio to be used in valuing stock should not be disturbed if there is a basis in the record.

R. Franklin Balotti, Esquire, and Jesse A. Finkelstein, Esquire, of Richards, Layton & Finger, Wilmington, Delaware, for plaintiffs.

William O. LaMotte III, Esquire, and Lawrence A. Hamermesh, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for defendant.

BROWN, *Chancellor*

This is an appraisal action that was filed initially in 1976. Under the procedure existing at that time, an appraiser was appointed to hear the evidence and to make a report and recommendation to the Court as to the judgment to be entered. The appraiser was appointed in 1977 but for reasons which are not disclosed the matter did not come on for a hearing before him until December, 1981. Briefing then took place. Thereafter the appraiser issued his draft report to the parties in June, 1982. Both sides took exception to his proposed conclusion. The appraiser then issued his final report in August, 1982 in which he determined that the fair value of the stock in question on the date that the plaintiffs were involuntarily merged out of their equity position in the corporation was $2.828 per share. Both sides have taken exception to his final report.

Since the hearing before the appraiser the plaintiffs have changed attorneys and the Supreme Court has rendered its decision in *Weinberger v. UOP, Inc.*, Del. Supr., 457 A.2d 701 (1983). These events have caused the presentation before the Court to divide into two separate aspects. First, for the reasons set forth in a 125 page opening brief filed by their former attorney, plaintiffs take the position that the appraiser's findings were in error based upon the record before him. For different reasons the defendant also contends that the appraiser's determination was erroneous. Secondly, and in reliance on the *Weinberger* decision, plaintiffs contend that the matter should be reopened and remanded to the appraiser with directions that he consider certain aspects of value which were not considered by him at the 1982 hearing.

Having reviewed the lengthy briefs and the arguments of the parties, I conclude that the determination of the appraiser should be accepted and entered as the judgment of the Court.

I.

The corporate stock in issue here is that of ACTS Computing Corporation (hereafter "ACTS"). The corporation was formed in the late 1960's as a computer time sharing company. A controlling in-

terest in it was eventually acquired by the defendant Lear Siegler, Inc. ("Lear Siegler") and on June 9, 1976 a short-form merger was effected by Lear Siegler whereby it acquired all remaining outstanding shares of ACTS. Prior to the merger the business of ACTS had grown consistently, but its long-term debt had done likewise. Its need for capital brought about the ownership of a majority of its shares by another corporation which, in turn, sold that controlling interest to Lear Siegler. In time, Lear Siegler acquired additional ACTS shares, eventually increasing its holdings to more than 90% so as to be in a position to remove the remaining shareholders through the short-form merger. Lear Siegler acquired its initial controlling interest in ACTS at a price of $.74 per share. It later acquired additional shares at $1.00 per share. Apparently, the highest price paid by Lear Siegler for ACTS' shares was $1.50 per share shortly before the merger.

After gaining control, Lear Siegler caused ACTS to handle a substantial amount of Lear Siegler's data processing needs. Lear Siegler paid ACTS for this service. As of the time of the merger ACTS had limited its services to a few customers, of which Lear Siegler was apparently the largest.

The plaintiffs are Eliot Charlip and Francis J. Kane and Helen Kane, his wife. They are the only former shareholders of ACTS who have pursued an appraisal action under 8 *Del. C.* § 262. Charlip and Francis J. Kane are two of the four original founders of ACTS. They were removed from management positions in ACTS when Lear Siegler gained control.

The breadth of the dispute that has developed in this proceeding tends to border on the absurd. Before the appraiser each side offered expert testimony in support of their valuation positions. Other witnesses were also called during the course of a two-day hearing. The result is that the plaintiffs claim that the value of their ACTS stock on the day of the merger was $22.46 per share while Lear Siegler takes the position that it was worth only $.545 per share. Thus, supported by the testimony of their qualified financial experts, the parties are almost $22 per share apart on a stock that had no active trading market immediately prior to the merger, with Lear Siegler contending that it was worth less than $1 per share.

II.

There would appear to be no question that the financial picture of ACTS at the time of the merger was somewhat less than spectacular. Its debt/equity ratio was approximately 9 to 1. It had never paid a

dividend. And even though its gross sales had grown dramatically over a period of years, its earnings for the first four years of the five-year period immediately preceding the merger appear to have averaged about $.01 per share.

Plaintiffs contend, however, that Lear Siegler, as controlling shareholder, purposely stifled and reduced the performance of ACTS in order to justify a low merger price. They point out that at the hearing before the appraiser an underpayment by Lear Siegler to ACTS of $366,000 was brought to light. They point further to the fact that the financial records of ACTS were less than accurate, with Lear Siegler's own financial expert being forced to concede that generally accepted accounting principles had not been utilized in certain instances as to the financial information of both Lear Siegler and ACTS. Thus, plaintiffs contend that the appraiser did not have a proper and adequate record before him on which to base the determination that he made.

For example, plaintiffs refer to the practice recognized by our appraisal law of using a five-year historical earnings average in computing the earnings element in a stock appraisal proceeding. They contend that accurate figures for the five-year period preceding the merger were unavailable here and they say that it was for this reason that the appraiser used only the earnings record for the one year immediately preceding the merger in making his determination. This, they say, was error. In such a situation they argue that it is necessary to reconstruct earnings, which was the approach followed by their expert.

The appraiser rejected the plaintiffs' effort at this approach, however, and I find that he was justified in doing so. As the appraiser noted, the plaintiffs attempted through their expert to develop a "financial model" for ACTS for the five-year period of 1972-1976, and to utilize the figures derived from this reconstruction to support their $22.46 per share price. Summarized generally, since ACTS was supplying the computer service needs of its parent, Lear Siegler, plaintiffs' expert assumed that ACTS' billings to Lear Siegler should have equated with a percentage of Lear Siegler's sales in each of the years, and thus he assumed a corresponding increase in ACTS net revenues for those years. Plaintiffs then postulated that the yearly general and administrative expenses of ACTS should equate with the weighted average of such expenses for eleven companies agreed upon by the parties to be comparable to ACTS. A tax rate and other factors were then figured in so as to arrive at a reconstructed figure of $.72 per share representing the weighted average earnings for ACTS for the

five-year period. Plaintiffs then derived a multiplier of 31.2 by obtaining a weighted average price/earnings ratio for the eleven comparable companies and, by multiplying the two figures, arrived at their valuation of $22.46 per share.

The appraiser found, however, that the sole basis for the plaintiffs' initial premise that the revenues of ACTS should have been higher than actually reported was a 1975 newspaper article which indicated that following its decision to have ACTS take over its computer services pertaining to its payroll systems, Lear Siegler was spending some $2 million less per year for data processing at a time when its growth rate had increased by $100 million. The appraiser reasoned that this one newspaper article did not provide an adequate foundation for plaintiffs' assumed premise, especially since there was no evidence before him that Lear Siegler had purchased computer services from ACTS for less than reasonable prices. The appraiser further reasoned that the fact that eleven comparable computer service companies could be said to have a certain weighted average for general and administrative expenses did not justify a finding that the same weighted average was applicable to ACTS. Thus, he rejected the plaintiffs' reconstructed figures as being unreliable.

The appraiser then noted that the only other evidence before him of the annual earnings of ACTS was that offered by Lear Siegler. Since ACTS' earnings for the year preceding the merger had been $.181 per share, and since the appraiser was satisfied on the evidence that this figure would have far exceeded the earnings for any of the prior four years (the appraiser finding also that ACTS reported earnings figures for those four years were unreliable due to certain accounting and reporting procedures) he gave the plaintiffs the benefit of the doubt and used $.181 as the earnings element even though it did not represent an average of five years historical earnings.

Against this the appraiser applied his own multiplier which he derived for his own reasons from an average price/earnings ratio for four of the eleven comparable companies. In so doing, he rejected Lear Siegler's argument that because the performance of ACTS was below that of all of the eleven comparable companies the multiplier to be used should be 6, that being the lowest price/earnings ratio among those of the eleven comparable companies. As a result, the appraiser applied a multiplier of 15.625 against the earnings figure of $.181 to arrive at his $2.828 per share valuation.

[1,2] The arguments of the plaintiffs are many as to the matters which, in their view, the appraiser allegedly failed to give appropriate consideration. As a practical matter, however, the lengthy opening

brief that they have filed with the Court is the same brief that they filed on the evidence with the appraiser. Thus, in effect, they are seeking to argue all of the facts of the matter anew before the Court. But I do not deem it proper, in considering exceptions taken from the report of a master or an appraiser, to ignore his findings and review the entire evidentiary record anew just as though his effort had never taken place. The purpose in utilizing a master or an appraiser is to assist the Court in expediting its business through the services of a Court-appointed fact-finder in the first instance. The procedure is not meant to afford the parties a means by which to take two full-sized bites at the same apple.

[3] Certainly, in reviewing the report of a master or an appraiser the Court is free to draw its own conclusions from the evidence if the findings of the report are clearly wrong and if justice therefore requires that the Court do so. However, if the determination of the master or appraiser is supported by the record and appears to be the product of an orderly and deductive reasoning process, it should be accepted without the necessity of the Court reiterating or setting forth the same factual matter and contentions already covered by the master or the appraiser. Compare, *Application of Delaware Racing Association*, Del. Supr., 213 A.2d 203 (1965); *In re General Realty & Utilities Corp.*, Del. Ch., 52 A.2d 6 (1947).

Such is the case here. The appraiser is a highly reputable and long-standing member of the Delaware bar with considerable experience in significant corporate matters. I find his determination and recommendation as to the value to be placed on the ACTS stock as of June 9, 1976 to be the product of a logical and deductive reasoning process based upon the nonspeculative evidence before him which he found to be reliable for purposes of his task. Accordingly, I find the exceptions to his report taken by the plaintiffs to be without merit.

III.

As noted previously, the plaintiffs seek in the alternative to have the proceedings remanded to the appraiser and reopened, with instructions that he consider certain elements of value which were neither presented nor considered by him at the 1982 hearing. This alternative application comes about as follows.

Through their original attorney plaintiffs stipulated prior to the hearing before the appraiser that neither asset value nor market value would be a part of the case and that the appraisal of the value of a share of ACTS as of the merger date would be based solely upon evidence relating to earnings value. Accordingly, no evidence of asset

or market value was offered by the plaintiffs nor was any such evidence considered by the appraiser, his determination being based exclusively on evidence relating to earnings as indicated previously herein.

Thereafter, following the hearing and the submission of the appraiser's final report, the Supreme Court handed down its decision in *Weinberger v. UOP, Inc., supra.* In that decision the Supreme Court stated that the appraisal statute, in its present form, "now *mandates* the determination of 'fair' value based upon 'all relevant factors'." (Emphasis added.) Only the speculative elements of value arising from the expectation or accomplishment of the merger were specifically exempted from consideration. 457 A.2d 713.

Plaintiffs argue that the decision in *Weinberger* is sufficiently timely to govern the outcome of this ongoing appraisal action and that accordingly a valid determination of the value of their ACTS shares cannot be made without taking into consideration the market and asset value of ACTS together with any and all other relevant factors. Stated differently, the plaintiffs are saying that to the extent that the appraiser failed to consider asset value and market value, his finding was not in compliance with the law by which a proper valuation of their stock must be measured.

As to the stipulation executed by their former attorney, they say that it is ineffective since parties cannot by stipulation agree to have a Court apply law different from that which otherwise governs a controversy.

Green v. Wilmington Savings Fund Society, Del. Supr., 310 A.2d 638 (1963). Moreover, they say that their former attorney entered into this stipulation without their knowledge or authorization. They say that in effect they were duped into going along with this stipulation since Lear Siegler had refused to produce information relating to asset value during discovery and thus they believed through a mistake as to the status of the law that Lear Siegler could not be required to produce this information and that they had no choice but to agree to the deletion of this element of value from the case. Finally, they argue that an appraisal action is really a form of class action brought on behalf of all former shareholders who have qualified for an appraisal under the statute and that accordingly the parties prosecuting the action have no power to stipulate away lawful rights belonging to the other former shareholder members of the class, citing *Application of Wilmington Suburban Water Corp.*, Del. Super., 203 A.2d 817 (1964), *aff'd in part and rev'd in part*, Del. Supr., 211 A.2d 602 (1965). For all of these reasons they would have the stipulation declared a nullity

and have the proceedings remanded to the appraiser for the taking and consideration of additional evidence.

Conceding without deciding for the purpose of argument that the general status of the law supports all of the foregoing propositions, I do not find these arguments of the plaintiffs to be persuasive on the present record. For one thing, the record indicates that Lear Siegler made formal objection to the plaintiffs' discovery requests pertaining to asset value and that at no time thereafter did plaintiffs attempt to seek a ruling on the validity of these objections through the normal practice of moving to compel discovery. Whether or not plaintiffs would have been entitled to the asset information they sought constitutes an unknown at this point since they chose not to pursue their demand for it in the preparation of their case. Moreover, I agree with Lear Siegler that it is difficult to give credence to plaintiffs' contention that the stipulation came about due to a mistake of law on their part since they are claiming at the same time that the stipulation was entered into by their attorney without their knowledge or authorization. In this regard I also take note of Lear Siegler's undisputed contention that the plaintiff Charlip is a lawyer.

[4] As to plaintiffs argument based upon their status as a type of class action representatives, I might conceivably agree with it but for the fact that in this action there are no former shareholders other than the plaintiffs who are seeking an appraisal. Thus, in the context of this action plaintiffs speak only for themselves and thus any right that they may have waived through a pre-hearing stipulation relates only to their own pecuniary interests. I think that this factor also answers their argument that they could not, through stipulation, agree to have a different standard apply to the adjudication of their rights other than that mandated by the law.

Under the law then as now plaintiffs were entitled to present evidence on the asset and market values attributable to the ACTS stock and to have the appraiser consider it in reaching his determination. For whatever the reason their attorney chose not to do so. This constituted nothing more than a concession on plaintiffs' part that insofar as their individual interests were concerned they were willing to have them evaluated based on the earnings factor alone. This is trial strategy, pure and simple. The apparent fact of the matter is that plaintiffs were not prepared at the time of the hearing to offer evidence as to either market value or asset value and, having no such evidence to offer, their counsel agreed by stipulation to remove these otherwise normally relevant matters from consideration. Having

thereafter suffered an adverse finding at the hearing, plaintiffs are now attempting through new counsel to use the decision in *Weinberger* as a means to get a new hearing based on the fact that the appraiser failed to consider evidence which they did not have at the time and did not care to present. I do not construe *Weinberger* to mandate such a result since it would equate to the proposition that in an appraisal action the Court must weigh and consider factors as to which the parties have offered no evidence in order to legally determine the fair value of a share of stock on a given date.

[5] As to the power of an attorney to bind his clients by stipulation made without their express authorization during the course of litigation, the law in our State would seem to be clearly set forth in *Trans World Airlines, Inc. v. Summa Corp.*, Del. Ch., 394 A.2d 241, 245 (1978) wherein Chancellor Marvel held that it is essential in advancing the interests of justice that the attorney-client relationship "permit an attorney to enter into stipulations and admissions in the course of representing his client." In that case the Chancellor refused to hold an evidentiary hearing to determine whether or not a client had been capable of authorizing his former counsel to file an answer on his behalf admitting the allegations of the complaint.

Finally, as to plaintiffs contention that the stipulation was entered into by their former attorney without their knowledge, I take note that the transcript of the proceedings before the appraiser reveals that on the first day of the hearing plaintiffs' former counsel, preparatory to examining plaintiffs' expert witness, pointed out to him that the parties had entered into a stipulation, approved by the appraiser, that neither asset value nor market value was a factor and that the sole approach to valuation at the hearing would relate to earnings. Plaintiffs were in attendance when this statement was made and there is no indication that they voiced any objection to proceeding on that basis.

Accordingly, I find the plaintiffs' application to remand and reopen the proceedings before the appraiser to be without merit.

IV.

[6] Finally, Lear Siegler has excepted to the appraiser's findings because he failed to use the lowest price/earnings ratio among the eleven comparable companies in making his calculations and because he refused to apply a 50% discount to the value figure reached by him as a result of his calculations. As to the first point, the appraiser's determination of a price/earnings ratio to be used in valuing the ACTS stock has a basis in the evidentiary record and I see no reason to disturb it. As to the second contention, I reject it also.

Lear Siegler's expert theorized that the ultimate earnings figure for ACTS derived by multiplying annual earnings by a selected price/earnings multiplier should be discounted by 50% in order to translate the earnings figure into the true fair value of a share of ACTS on the date of the merger. His reason for this was that there was no market for ACTS stock due to Lear Siegler's 90% plus interest in the company among other things, and that as a consequence an earnings value standing alone did not accurately reflect the value of the shares.

I agree with the plaintiffs that this is not an acceptable premise in view of the stipulation of the parties by which it was agreed that the market value element was not to be considered by the appraiser. In essence, it is an argument by Lear Siegler that the market value of the ACTS stock was so inconsequential as to be unworthy of any consideration whatever in attempting to reach a fair value for the stock, but that in order to reach a fair value based on earnings alone any final earnings figure would have to be reduced by 50% to reflect the fact that there was no market for the stock.

To my view this argument is a form of *non sequitur*, as I presume it was to the appraiser also. I do not find that he erred in rejecting it. Accordingly, I find that exception taken by Lear Siegler to also be without merit.

V.

In summary, the exceptions taken to the report of the appraiser are denied, as is the application of the plaintiffs to remand and reopen the proceedings before the appraiser. The determination of the master of $2.828 as set forth in his report will be entered as the judgment of the Court. An appropriate form of order may be submitted.

DART v. KOHLBERG, KRAVIS, ROBERTS & CO.

No. 7366

Court of Chancery of the State of Delaware, New Castle

November 30, 1984

In plaintiff's challenge to a leveraged buy-out plan seeking to merge

two newly formed corporations to form a new third corporation, a discovery dispute arose. Defendants moved to strike plaintiff's amended complaint as being so without merit as to be a sham pursuant to Court of Chancery Rule 11, and sought to depose plaintiff's attorney to determine whether there was sufficient knowledge upon which to base the allegations. Plaintiff moved for a protective order.

The court of chancery, per Vice-Chancellor Hartnett, granted the motion for a protective order noting that although an attorney representing a party to the litigation is not immune from being deposed, because such a ploy could be designed to obtain privileged information or to harass the opponent, deposition should be allowed only where there is no other source of information available to resolve the Rule 11 motion. The court, recognizing the potential for abuse in a leveraged buy-out, found plaintiff's testimony and the record sufficient to demonstrate that the allegations were made in good faith and were not a sham.

1. Federal Civil Procedure ⟹ 1323
   Discovery ⟹ 48

An attorney is not immune from being required to give a deposition even when representing a party to the litigation.

2. Federal Civil Procedure ⟹ 1323, 1332
   Discovery ⟹ 44

A court should not allow indiscriminate taking of the depositions of counsel, as to do so would be to permit harassment.

3. Pleading ⟹ 288

A motion to dismiss under Rule 11 is not to test whether the complaint states a cause of action but rather to test the conduct of counsel. It is a subjective test as to whether the attorney had good ground to support the allegations. DEL. CH. CT. R. 11.

4. Equity ⟹ 362

A party, in response to a Rule 11 motion to dismiss, is not required to show good grounds for the challenged pleading but only need show the good faith of the attorney in drafting the complaint. DEL. CH. CT. R. 11.

5. Federal Civil Procedure ⟹ 1323, 1332
   Discovery ⟹ 42, 44

A court must be careful not to encourage taking opposing counsels' depositions because much of the information upon which an attorney

may have based his signature may be privileged as attorney-client communications and work product.

6. Federal Civil Procedure ⟹ 1323, 1332
Discovery ⟹ 42, 44

Depositions of opposing counsel, taken purportedly for Rule 11 purposes, may create an abuse in attempting to acquire privileged information and are easily susceptible to being used merely to harass an opponent. DEL. CH. CT. R. 11.

7. Federal Civil Procedure ⟹ 1323, 1332
Equity ⟹ 362
Discovery ⟹ 44

If possible, the resolution of a Rule 11 motion to dismiss should be made on information from sources other than the deposition of counsel. DEL. CH. CT. R. 11.

8. Corporations ⟹ 581, 584

There is a great potential for abuse in a leveraged buy-out; by its very nature, it involves the exclusive use of corporate assets to buy out the owners of the corporation.

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

Stephen P. Lamb, Esquire, of Skadden, Arps, Slate, Meagher & Flom, of Wilmington, Delaware, for defendants.

HARTNETT, *Vice-Chancellor*

This is a discovery dispute in a purported class action suit in which the plaintiff challenges events related to the taking private of Amstar Corporation. Defendants moved to strike the Amended Complaint as a sham under Court of Chancery Rule 11. In order to pursue their motion defendants sought to take the deposition of plaintiff's counsel. Plaintiff has moved for a protective order to prevent the taking of the deposition. The motion for protective order must be granted.

I

The challenged transaction is a leveraged buy-out whereby the management of Amstar Corporation and defendants KKR Associates, Inc., and Kohlberg, Kravis, Roberts & Co. sought to merge two newly formed corporations which had no public stockholders, Amstar

Holdings, Inc., and Amstar Subsidiary, Inc., into Amstar Corporation, thus taking Amstar Corporation private. The transaction would be accomplished by Amstar Corporation using its own assets as security to borrow sufficient moneys to fund the buy-out. The majority of the common and preferred stockholders, voting as a class, approved the merger at the February 7, 1984 stockholders meeting and accepted $47 per share for the common shares. The preferred stockholders were offered $8 per share, which was substantially less than the redemption value of the preferred shares, but only if two-thirds of them voted in favor of the offer.

The preferred shares, prior to the offer, were redeemable at the option of the corporation at $13.125 per share. On liquidation, they are entitled to $12.50 per share. At the time of the merger they were trading at approximately $6 per share. Before the February 7 stockholder meeting, the plaintiff sent a letter to each of the record holders of preferred stock. In the letter he stated that he felt the $8 price was unfair and that he intended to pursue litigation challenging the transaction. He further stated that if the preferred stockholders were united and voted down the $8 proposal, the new owners of Amstar would surrender and redeem the stock for a price of $13.125 per share which Mr. Dart felt was fair.

Amstar Corporation responded by sending a Mailgram to each holder of preferred stock stating that they felt the $8 price was fair, that the corporation would not redeem the stock if the two-thirds vote was not achieved, and that they would zealously defend any litigation instituted by Mr. Dart.

Two-thirds of the stockholders did not vote for the merger and the preferred shares remain outstanding in what is now a private Amstar.

As a result of the merger, the position of the preferred stockholders has been altered. The company now has over $350 million of debt as opposed to less than $50 million before the buy-out. For a period of approximately one month the preferred stock was not listed on any exchange. It was dropped from the New york Stock Exchange after the buy-out and did not appear on the National Association of Securities Dealers Automated Quotation System until more than a month later.

II

Plaintiff asserts that the challenged transaction gave the preferred stockholders a choice between being cashed-out at a price below stated redemption or liquidation value or remaining minority stockholders

in a private corporation which is heavily in debt and may be unable to pay preferred dividends. The buy-out plan, he claims, constituted a breach of fiduciary duty on the part of the directors of the corporation. Plaintiff also alleges material misrepresentations and omissions, in the Proxy Statement.

Defendants claim that these allegations in the complaint are so without merit as to be a sham and false and therefore should be stricken pursuant to Rule 11. They now seek to depose plaintiff's attorneys to determine whether there was sufficient knowledge upon which to base the allegations in the Amended Complaint.

Chancery Court Rule 11 states:

> Every pleading of a party represented by an attorney shall be signed by at least 1 attorney of record in his individual name, whose address shall be stated. A party who is not represented by an attorney shall sign his pleading and state his address. Except when otherwise specifically provided by statute or rule, pleadings need not be verified or accompanied by affidavit. The signature of an attorney constitutes a certificate by him that he had read the pleading; that to the best of his knowledge, information, and belief there is good ground to support it; and that it is not interposed for delay. If a pleading is not signed or is signed with intent to defeat the purpose of this rule, it may be stricken as sham and false and the action may proceed as though the pleading had not been served. For a willful violation of this rule an attorney may be subjected to appropriate disciplinary action. Similar action may be taken if scandalous or indecent matter is inserted."

III

[1, 2] An attorney is not immune from being required to give a deposition even when he represents a party to the litigation. WRIGHT & MILLER, *Federal Practice and Procedure*: Civil § 2102. See also *Hunt International Resources Corp. v. Binstein*, N.D. Ill., 98 F.R.D. 689 (1983); *In Re Arthur Treacher's Franchise Litigation*, E.D., Penn., 92 F.R.D. 429 (1981); *In Re Penn Central Commercial Paper Litigation*, S.D.N.Y., 61 F.R.D. 453 (1973); *Sagorsky v. Malyon, S.D.N.Y., 12 F.R.D. 468 (1952)*. A court, however, should not allow indiscriminate taking of the depositions of counsel. To do so would be to permit harassment. See *Sundin, et al. v. Fisher, et al.*, Del. Ch., C.A. No. 6918-N.C., Longobardi, V.C. (Sept. 9, 1983).

In *Brown v. Hart, Schaffner, & Marx*, N.D. Ill., 96 F.R.D. 64 (1982), the Court allowed the taking of counsels' depositions where there were charges under Rule 11 that the complaint was a sham. The Court noted, however, that the plaintiff had admitted that she had done no research into the facts behind the complaint. The attorneys were the only sources for establishment of the knowledge, information, and belief upon which the complaint was based.

[3, 4] The purpose of Rule 11 is not to test whether the complaint states a cause of action, but rather to test the conduct of counsel, and it is a subjective test as to whether the attorney had good ground to support the allegations. *Singer v. Creole Petroleum Corp.*, Del. Supr., 311 A.2d 859 (1973). A party, therefore, in response to a Rule 11 motion, is not required to show a good ground basis for the pleading; but only needs to show the good faith of the attorney in drafting the complaint. *Id.*

The Court in *Singer* overturned a dismissal with prejudice which had been granted pursuant to a Rule 11 motion. Although the Court stated that if an attorney signs a pleading in violation of his certification that to the best of his knowledge, information, and belief there is a good ground to support the pleading, the pleading is signed with the intent to defeat the purpose of Rule 11, the Court was silent about deposing attorneys to discover whether they had violated their certification. The *Singer* opinion also stressed the extraordinary nature of a Rule 11 motion dismissal.

IV

[5-7] A court must be careful not to encourage the taking of opposing counsels' depositions because much of the information upon which an attorney may have based his signature may be privileged as attorney-client communications and work product. Depositions, taken purportedly for Rule 11 purposes, may create an abuse in attempting to acquire privileged information and are easily susceptible to being used merely to harass an opponent. If possible, therefore, the resolution of a Rule 11 motion should be made on information from sources other than the deposition of counsel.

[8] The testimony already given by Mr. Dart is sufficient to demonstrate that the allegations were made with good faith even if they may not be based upon established law with a long line of precedents. His deposition testimony indicated that much of the complaint was based upon his knowledge and beliefs. From his testimony it is clear that he has made a showing that the allegations

have enough foundation not to be a sham. There is a great potential for abuse in a leveraged buy-out. By its very nature it involves the exclusive use of corporate assets to buy out the owners of the corporation. An investor, such as Mr. Dart, who is also a retired attorney, would have likely been sufficiently suspicious of the transaction from a reading of the proxy materials to reasonably believe that the transaction could be subject to a challenge in this Court and a careful reading of the Amended Complaint shows that it is not a sham. The factual allegations made in it seem to be sufficiently derived from the proxy materials as to not be patently false.

On balance, therefore, there has been an insufficient showing in this case of a valid reason to allow defendants to take the unusual step of deposing plaintiff's counsel and, in the interests of substantial justice, the plaintiff's motion for a protective order must be granted.

IT IS SO ORDERED.

DEVON v. PANTRY PRIDE, INC.
Nos. 7843 & 7849
Court of Chancery of the State of Delaware, New Castle

November 21, 1984

On November 2, 1984, Philip Devon, a stockholder, made a demand for a stockholder list of Pantry Pride to solicit proxies for an annual board meeting which was set for December 6, 1984. However, Philip Devon died on November 5, 1984. Dwight Devon, as executor of the estate of Philip Devon, filed an action to inspect the stockholder lists and also filed an action on his own behalf. Dwight Devon filed his action on November 6, 1984, although he did not become a stockholder of record until November 15, 1984. Fred Mandato, another stockholder, made his demand for the stockholder list on November 12, 1984. These actions were consolidated for trial.

The court of chancery, per Vice-Chancellor Hartnett, held that: (1) the evidence indicated that the demand stated a proper purpose; (2) the laws of Delaware and of New York, where plaintiff resides, provide for the general survival of causes of action, unless specifically

prohibited by statute; (3) Philip Devon's action did survive and ripened five days after the demand; (4) Dwight Devon was not personally able to make the demand on November 6, 1984, since he was not a stockholder of record at that time; and (5) plaintiffs may also seek other materials which they need to meaningfully communicate with the stockholders. The court found it unnecessary to rule on the demand by Mandato since he was allied with Dwight Devon in the ongoing proxy context.

1. Corporations ⟹ 181(5)

A proper purpose is stated when stockholders demand a list of stockholders to communicate with them about a forthcoming annual meeting and solicitation of proxies. DEL. CODE ANN. tit. 8, § 220 (1974).

2. Executors and Administrators ⟹ 425

Executors have the power to maintain an action which could have been maintained by the decedent.

3. Executors and Administrators ⟹ 425

A statutory right of action survives unless specifically restricted by statute. DEL. CODE ANN. tit. 10, § 3707 (1974).

4. Corporations ⟹ 170, 181(3)

A beneficial owner who is not a stockholder of record is not entitled to an inspection of the stockholder list. DEL. CODE ANN. tit. 8, § 220 (1974).

5. Corporations ⟹ 181(5)

Stockholders are entitled to receive any corporate materials necessary to meaningfully communicate with the stockholders list.

Stephen J. Rothschild, Esquire, Edward P. Welch, Esquire, and Stephen E. Jenkins, Esquire, of Skadden, Arps, Slate, Meagher & Flom, Wilmington, Delaware, for plaintiff.

William Prickett, Esquire, John H. Small, Esquire, and Elizabeth M. McGeever, Esquire, of Prickett, Jones, Elliott, Kristol & Schnee, Wilmington, Delaware, for defendant.

HARTNETT, *Vice-Chancellor*

This is an action whereby the plaintiffs seek to inspect the stockholder list of Pantry Pride, Inc., a Delaware corporation. After

trial on November 20, 1984, I find that the request must be granted.

I

The annual meeting of the stockholders of Pantry Pride, Inc. is now set for December 6, 1984, a little over two weeks hence. Pantry Pride, Inc. has sent to its stockholders management's proxy materials and has also sent an amendment. Numerous references to a proxy fight involving Pantry Pride, Inc. have already appeared in the press.

The legal issue presented in this suit is unique because the original demand for the stockholder list was made on November 2, 1984, by Philip Devon, a stockholder. The demand was in order and in the normal course of events Philip Devon would have been entitled to inspect or receive the list of stockholders in order to communicate with them about the forthcoming annual meeting. Unfortunately, Philip Devon died on November 5, 1984.

On November 13, 1984, Dwight Devon, Dana Devon and Edward J. Landau, who were named Executors in Philip Devon's Will, were granted Preliminary Letters Testamentary by the New York Surrogate Court. The Executors desire to continue the solicitation of proxies commenced by Philip Devon and seek to inspect the stockholder list for that purpose.

Dwight Devon, one of the Executors, also desires to pursue the proxy solicitations on his own behalf and on November 6, 1984, he filed a new demand to inspect the stockholder list, although he was not a stockholder of record at that time because he did not own any shares of Pantry Pride, Inc. in his own name.

Dwight Devon was, however, subsequently able to register 565,424 shares of stock of Pantry Pride, Inc. in his own name on November 15, 1984. The shares had formerly been held in a Voting Trust which terminated upon his father's death.

On November 12, 1984, another demand for inspection of the stockholder list was made by Fred Mandato—another stockholder of Pantry Pride, Inc.

Pantry Pride, Inc. has failed to permit an inspection in response to any of the demands although it has offered to mail to its stockholders any communications the plaintiffs desire to have sent.

Dwight Devon, individually and as Co-Executor of the Estate of Philip Devon, filed Civil Action #7843. Fred Mandato filed Civil Action #7849. Both actions were consolidated for trial over the vigorous objections of the defendant.

II

[1] It is clear from all the evidence that all the demands state a proper purpose: to solicit proxies. *Kerkorian v. Western Air Lines, Inc.*, Del. Ch., 253 A.2d 221, *aff'd.*, Del. Supr., 254 A.2d 240 (1969).

Any technical defect in the wording of the demands was cured at trial. *Odyssey Partners v. Trans World Corp.*, Del. Ch., C.A. No. 7125-N.C., Hartnett, V.C., (Mar. 29, 1983); *Hatleigh Corp. v. Lane Bryant, Inc.*, Del Ch., C.A. No. 6318-N.C., Hartnett, V.C., (Feb. 5, 1981).

III

It is also clear that the deman made by Philip Devon before his death supports Dwight Devon's action and therefore Dwight Devon is entitled to the materials he seeks.

[2] Dwight Devon, along with others on whose behalf he acts, has been issued Preliminary Letters Testamentary in New York. The New York Surrogate's Court Procedure Act (SCPA) grants executors the power to maintain an action that could have been maintained by the decedent. SCPA § 1412(3); *New York Estates Powers and Trust Laws* § 11-3.1.

10 Del. C. § 3701, as it now exists in its amended form, provides for a general survival of causes of action. Defendants concede as much but assert that the cause of action of Philip Devon had not yet ripened because five business days had not lapsed between the date of Philip Devon's demand and his death.

Defendant's argument that the cause of action did not survive because it was not ripe is without merit. While Philip Devon was not entitled to receive the materials he sought on November 5, 1984—the date of his death—because five business days had not expired since his demand, his right of inspection, or his right to compel inspection, did exist. It existed subject, however, to the requirement that the corporation had five business days in which to furnish the materials.

[3] 10 *Del. C.* § 3707 also provides that a statutory right of action shall survive unless it be specifically restricted in the statute.

The cause of action of Philip Devon therefore survived his death and may be maintained on behalf of the Estate by Dwight Devon, his Co-Executor.

IV

I find that defendants did not adduce sufficient evidence to establish the affirmative defenses of laches or unclean hands. This is merely

an action seeking a stock list and other information necessary to conduct a proxy battle.

V

[4] I also find that Dwight Devon was not a stockholder of record when he made his demand on November 6, 1984. He was only a beneficial owner at that time and because he sought relief pursuant to 8 *Del. C.* § 220 he is not entitled to an inspection based on his November 6, 1984, demand. *Lenahan v. National Computer Analysts Corp.*, Del. Ch., 310 A.2d 661 (1973).

VI

It is not necessary to rule on Fred Mandato's request to be permitted to seek the materials in view of my ruling that Dwight Devon is entitled to the materials. Fred Mandato and Dwight Devon are allied in this ongoing proxy contest.

VII

Plaintiffs, in addition to seeking to inspect the stock-list of the defendant, also seek certain other materials which they need to meaningfully communicate with the stockholders of Pantry Pride, Inc. They are entitled to them. *Goldman v. Aegis Corp.*, Del. Ch., C.A. No. 6396-N.C., Hartnett, V.C., (April 7, 1981); *Hatleigh Corp. v. Lane Bryant, Inc.*, supra; *Lerman v. Diagnostic Data, Inc.*, Del. Ch., C.A. No. 6233-N.C., Brown, V.C. (Aug. 11, 1980).

Defendants are directed to immediately furnish plaintiff Dwight Devon with copies of the demanded materials, and to continue to supply him with current materials as they become due.

Costs shall be assessed against defendant.

IT IS SO ORDERED.

ERCKLENTZ v. INVERNESS MANAGEMENT CORP.

No. 7167

Court of Chancery of the State of Delaware, New Castle

October 18, 1984

Plaintiff brought a class and derivative action against defendant Inverness Management Corporation alleging various breaches of fiduciary duty. Defendant moved to disqualify plaintiff's counsel and moved to dismiss on the ground that plaintiff, a former member of the corporation's board of directors and former general counsel, was an inadequate derivative or class representative. Plaintiff's counsel had previously represented defendant and two of its directors in an action involving the determination of the rightful board of directors.

The court of chancery, per Vice-Chancellor Berger held that: (1) the attorney who previously represented defendant could not properly represent plaintiff in the pending litigation; and (2) plaintiff, because of his former relationship with defendant, was not a suitable representative of the class and therefore should also be disqualified.

1. Attorney and Client ⟹ 20

In order to prevail on a motion to disqualify counsel, it must be established that the issues in the present case are substantially related to those in a previous litigation.

2. Attorney and Client ⟹ 21

If it can reasonably be said that in the course of the former representation the attorney might have acquired information related to the subject of a subsequent representation, then the relationship between the two matters is sufficiently close to prohibit the latter representation.

3. Attorney and Client ⟹ 21

A party seeking to disqualify former counsel must satisfy a high standard of proof; a substantial relationship will be found only when the issues involved in the two representations have been found to be identical or essentially the same.

4. Attorney and Client ⟹ 21

The attorney will generally be disqualified whenever the subject matter of the second representation is so closely connected with the

subject matter of the earlier representation that confidences might be involved.

5. Attorney and Client ⟹ 21

The same ethical considerations which bar an attorney from acting as counsel against former clients also precludes the attorney from acting as a class or derivative plaintiff against the former client.

William Prickett, Esquire, of Prickett, Jones, Elliott, Kristol & Schnee, Wilmington, Delaware, for plaintiff.

Bruce M. Stargatt, Esquire, of Young, Conaway, Stargatt & Taylor, Wilmington, Delaware, for defendants.

BERGER, *Vice-Chancellor*

This is a class and derivative action brought by Enno W. Ercklentz, Jr. ("Ercklentz") against Inverness Management Corporation ("IMC") and its current Board of Directors alleging wrongful dilution of IMC's common stock, waste of corporate assets and other breaches of fiduciary duty. Defendants answered and counterclaimed, moved for summary judgment on various grounds, moved to dismiss on the ground that Ercklentz is an inadequate class or derivative plaintiff and moved to disqualify plaintiff's counsel, the law firm of Prickett, Jones, Elliott, Kristol & Schnee (the "Prickett firm"). This is the decision on defendants' motion to dismiss and disqualify.

The motion to disqualify is based upon the Prickett firm's prior representation of IMC and two of its directors, John Soutter ("Soutter") and Garrick Stephenson ("Stephenson"), in an action filed in this Court in December, 1975 captioned *Chew, et al. v. IMC, et al.*, Civil Action No. 4968 ("*Chew*" or the "*Chew* litigation"). That suit began as an application under 8 *Del. C.* § 225 for a determination of the rightful Board of Directors of IMC. Plaintiffs were dissident stockholders who claimed to have removed the then existing IMC Board of Directors (including Soutter and Stephenson) by written consent. Pending the outcome of that litigation, the dissidents sought an order restraining defendants from (1) issuing additional IMC stock; (2) transferring or selling any real or personal property of the corporation other than in the ordinary course of business; (3) wrongfully diverting IMC's corporate funds; and (4) prepaying any of IMC's loans.

The motion for a preliminary injunction was heard on December 31, 1975 at which time Mr. Prickett, representing defendants, argued that the litigation was threatening the then pending sale of an IMC

subsidiary, Aunt Millie's Sauces, Inc. ("Aunt Millie's") to a third party. Mr. Prickett explained that the whole purpose of that sale was to achieve a tax loss carry forward and to pay some of IMC's outstanding debts.

The motion for a preliminary injunction was denied by order dated January 6, 1976. On the same date, the *Chew* plaintiffs filed an amended complaint adding, among other things, allegations that certain common and preferred stock was illegally issued to Stephenson for the purpose of protecting the incumbent directors. A four day trial was conducted on January 7, 8, 19 and 20, 1976 during which time Mr. Prickett examined Stephenson on issues such as his loans to IMC, his plans to sell corporate assets and use the proceeds to reduce IMC's debt, his reaction, both as a stockholder and creditor, to the dissidents' attempt to obtain control of IMC and the issuance to him of common and preferred stock in December, 1975.

On February 13, 1976 this Court decided the *Chew* litigation holding that plaintiffs' slate of directors had not been elected because certain of the consents used to replace the IMC Board had been unlawfully purchased and were invalid. The *Chew* decision did not reach plaintiffs' claim that Stephenson was issued common and preferred stock in December, 1975 for an improper purpose.

Ercklentz, plaintiff in the present action, was a member of IMC's Board of Directors and its legal counsel from 1969 through 1979. His complaint alleges that, since 1971, Stephenson has been a substantial creditor of IMC and, since 1975, he has been IMC's dominant stockholder. Plaintiff claims that Stephenson has been engaged in a manipulative scheme "throughout the years" the sole purpose of which was to enable IMC to prepay its debt to Stephenson at the expense of IMC and its stockholders. The complaint challenges the following transactions, among others:

(1) The sale of Aunt Millie's in 1976 at an allegedly inadequate price and the allegedly wrongful use of the proceeds of that sale to reduce IMC's debt to Stephenson;

(2) The sale of Inverness Land & Cattle Management Co. ("Land & Cattle"), an IMC subsidiary, in 1978 to satisfy IMC's creditors including Stephenson;

(3) The exchange of certain preferred stock of Mardix Corporation ("Mardix") held by an IMC subsidiary for a promissory note that was subsequently transferred to Stephenson;

(4) The failure of IMC to take advantage of certain net operating loss carry forwards for federal income tax purposes during the years 1977 through 1981;

(5) The issuance of 30,000 shares of IMC common stock to Soutter in May 1981; and

(6) The exchange by Stephenson of certain IMC preferred stock for common stock in the summer of 1981.

[1, 2] In order to prevail on their motion to disqualify, defendants must establish that the issues in the present case are "substantially related" to those in the *Chew* litigation. *T. C. Theatre Corp. v. Warner Bros. Pictures*, 113 F. Supp. 265 (S.D.N.Y. 1953); *Grynberg v. Burke*, Del. Ch., C.A. No. 5198, Brown, V.C, (December 16, 1976). In *T. C. Theatre Corp.*, the United States District Court for the Southern District of New York stated:

> Lawyers should not put themselves in the position "where, even unconsciously, they might take, in the interests of a new client, an advantage derived or traceable to, confidences reposed under the cloak of a prior, privileged relationship." [footnote omitted] In cases of this sort the Court must ask whether it can reasonably be said that in the course of the former representation the attorney might have acquired information related to the subject of his subsequent representation. If so, then the relationship between the two matters is sufficiently close to bring the latter representation within the prohibition of Canon 6. *T. C. Theatre Corp. v. Warner Bros. Pictures, supra* at 269.

[3, 4] More recently, the Second Circuit Court of Appeals, while endorsing the "substantial relationship" test articulated in *T. C. Theatre Corp.*, noted that a party seeking to disqualify his former counsel must satisfy a high standard of proof and that, as a practical matter, a "substantial relationship" has been found only when the issues involved in the two representations have been "identical" or "essentially the same." However, in the Third Circuit the *T. C. Theatre Corp.* "substantial relationship" test has not been so restricted. In *Richardson v. Hamilton International Corporation*, 469 F.2d 1382 (3d Cir. 1972) in affirming the lower court's disqualification of an attorney acting as a class and derivative plaintiff, the court stated:

> [T]he courts in order to protect the communications between attorney and client, have generally disqualified an attorney whenever the subject matter of the second representation is "so closely connected with the subject matter of the earlier representation that confidences *might* be involved." ABA Informal Opinion No. 1233 (Aug. 24, 1972).

* * *

> . . . [W]e believe that the District Court was justified in concluding that the information [plaintiff] received in the prior SEC action might be related to the subject matter of his subsequent representation. (Emphasis in original).

Id. at 1385. *See also Pennwalt Corporation v. Plough, Inc.*, 85 F.R.D. 264 (D. Del. 1980).

Plaintiff argues that the motion must be denied because defendants have not established that the issues in the *Chew* litigation are essentially the same as those raised in this action. He points out that:

1. The Aunt Millie's sale referred to in the *Chew* litigation was never consummated. Aunt Millie's was sold several months after the termination of the *Chew* litigation and the Prickett firm did not represent IMC in connection with either the originally proposed sale or the actual transaction;

2. In the *Chew* litigation plaintiffs attacked the allegedly wrongful issuance of preferred stock to Stephenson whereas the present action attacks the exchange of that stock for common stock six years later; and

3. The other allegations in the present complaint involve transactions and events occurring long after *Chew* and in no way related to the previous case—the issuance of stock to Soutter in 1981, the failure to take advantage of net operating loss carry forwards and the Mardix transaction.

In addition, plaintiff argues that the duration of the Prickett firm's previous representation and the passage of time make disqualification inappropriate. The *Chew* litigation lasted for only two months and ended approximately seven years before this suit was filed. Plaintiff contends that the limited information the Prickett firm acquired about IMC's general financial condition in 1975 is not relevant to the challenged events which occurred several years later.

Although several of the specific allegations in the present complaint appear unrelated to the *Chew* litigation, the complaint, fairly read as a whole, raises some of the same issues addressed in *Chew*. Ercklentz attacks Stephenson's allegedly improper management of IMC to benefit himself as a creditor. By the time of the *Chew* litigation Stephenson had been a substantial creditor of IMC for approximately four years and Mr. Prickett argued that the dissident stockholders were trying to paint Stephenson "as a ruthless man exploiting Inverness and the stockholders and advancing himself as a creditor." (Transcript, January 28, 1976, p. 21).The Prickett firm attempted to dispel that characterization in *Chew*. The present action appears to pick up where *Chew* left off in early 1976. Thus, it is reasonable to assume that information

concerning Stephenson's motives as a stockholder and creditor during 1975 will be relevant to his allegedly wrongful conduct immediately thereafter.

In addition, the sale of Aunt Millie's was the subject of discovery and testimony in *Chew*. Specifically, Mr. Prickett elicited testimony from one of IMC's then directors that the Aunt Millie's sale was important to the overall financial well being of the company and was extremely important to Stephenson as a means of reducing IMC's indebtedness to him. (Testimony of John Weslty Hanes, *Chew* Trial Transcript, p. 423-426). The present complaint attacks both the adequacy of the consideration and the distribution of proceeds in the sale of Aunt Millie's consummated a few months after the *Chew* trial. Information learned by the Prickett firm about the proposed Aunt Millie's sale and Stephenson's interest in selling that asset appear to be directly in issue in the present case.

Assuming, without deciding, that defendants have the burden of establishing that the two representations are "essentially the same," I am satisfied that defendants have met their burden on at least two issues raised in the complaint—Stephenson's alleged manipulation of IMC for his own benefit from the time he became IMC's controlling stockholder in late 1975 and the alleged waste of corporate assets and improper distribution of proceeds in connection with the sale of Aunt Millie's in 1976. Accordingly, defendants' motion to disqualify is granted.

Defendants also seek to disqualify plaintiff from serving as a derivative or class representative in this action for either of two reasons. First, plaintiff was general counsel to IMC from July, 1969 to July, 1979 and defendants argue that Ercklentz must be disqualified for the same reasons as the Prickett firm. Second, plaintiff was a director of IMC during the same ten year period and voted to approve certain of the transactions now under attack. Defendants contend that Ercklentz's interests therefore conflict with those of the class he seeks to represent.

[5] As general counsel to IMC, plaintiff was privy to at least the same information regarding the *Chew* litigation as the Prickett firm. In addition, Ercklentz was actively involved in the negotiation and drafting of the agreement for the original proposed sale of Aunt Millie's and was IMC's general counsel at the time of the actual sale of Aunt Millie's, the sale of Land & Cattle in 1978 and the Mardix transaction. The same ethical considerations which bar an attorney from acting as counsel against his former client also preclude him from acting as a class or derivative plaintiff against his former client. *Richard-*

son v. Hamilton International Corporation, 469 F.2d 1382 (3d Cir. 1972); *Doe v. A Corporation*, 709 F.2d 1043 (5th Cir. 1983).

Plaintiff responds that he is not really suing his former client. As to the derivative claims, plaintiff is acting on behalf of IMC and as to the class claims, plaintiff argues that there are no allegations of any wrongdoing by IMC and no relief is sought from the company. In short, plaintiff argues that the sole wrongdoer is Stephenson who, at least technically, was never plaintiff's client.

I am not persuaded by plaintiff's argument. First, a corporation must act through its officers and directors. Although Stephenson, for example, may not have been plaintiff's client as such, he undoubtedly provided confidential information and received counsel from plaintiff as part of plaintiff's role as general counsel to IMC. Moreover, representation has been prohibited even where an attorney-client relationship never existed. *See Pennwalt Corporation v. Plough, Inc., supra*; Richardson v. Hamilton International Corporation, *supra*.

In conclusion, I find that Ercklentz must be disqualified from acting as plaintiff in this action for the same reasons that apply to his counsel. Inasmuch as Ercklentz is the only named plaintiff in this action it appears that the action must be dismissed unless another plaintiff wishes to pursue these claims. I request that defendants submit a proposed form of order in accordance with this opinion on notice.

FISHER v. UNITED TECHNOLOGIES CORP.

No. 5847

Court of Chancery of the State of Delaware, New Castle

October 10, 1984

Plaintiff, a minority stockholder in the target corporation, seeks to attack the propriety and validity of a merger subsequent to a tender offer. The court of chancery, per Vice-Chancellor Hartnett, denied plaintiff's motion to file a third amended complaint because (1) the new allegations should have been included in earlier amendments; (2) the claims were of doubtful legal sufficiency; and/or (3) plaintiff's delay would likely cause prejudice to defendant if defendant were forced to defend against the new allegations.

1. Corporations ⟹ 591

An issue of fact as to whether defendants knew, at the time of the merger proposal, that the value of convertible shares could never reach the stated amount in the foreseeable future is sufficient to withstand a motion for summary judgment.

2. Corportions ⟹ 581

A valid business purpose is not a prerequisite to a cash-out tender offer.

3. Pleading ⟹ 241

An amendment to a pleading will relate back to the date of the original whenever the claims in the amendment arise out of a conduct, transaction, or occurrence which was set forth or which was attempted to be set forth in the original pleading. DEL. CH. CT. R. 15(c).

4. Pleading ⟹ 233

The court of chancery may, in its discretion, permit amendment of pleadings after the pleadings have been closed. DEL. CH. CT. R. 15(a).

5. Pleading ⟹ 233

As a general rule, leave to amend pleadings should be liberally given. DEL. CH. CT. R. 15(a).

6. Pleading ⟹ 233, 245(1), 258(1)

A motion to amend should be made as soon as the necessity for altering the pleadings becomes apparent. But where there is neither improper motive on the part of the movant nor undue prejudice to the other party, unnecessary delay will not require denial of leave to amend. DEL. CH. CT. R. 15(a).

7. Pleading ⟹ 233

Where the facts upon which the amended complaint was based were known to the plaintiff at or before the time of an earlier amendment, leave to amend may be denied. DEL. CH. CT. R. 15(a).

8. Pleading ⟹ 238

The party seeking to amend a pleading should provide a valid explanation for any neglect or delay.

9. Pleading ⟹ 233

A trial court is not required to allow amendments of pleadings if the party seeking to amend has been inexcusably careless or if unfair prejudice to the other party would result. DEL. CH. CT. R. 15(a).

10. Pleading ⟹ 236(2), 238(1), 245(1)

Loss of evidence which would be necessary to challenge the claims of the proposed amendment is prejudicial to a non-amending party.

11. Pleading ⟹ 241, 242, 245(1)

Legal insufficiency of an amendment is grounds for denial of leave to amend.

12. Pleading ⟹ 241, 251

The standards employed by the court of chancery to determine legal sufficiency are equivalent to those employed under FED. R. CIV. P. 12(b)(6).

13. Pleading ⟹ 233, 241, 251

Where there is no set of facts which could be proven under an amendment to a complaint which would constitute a valid and sufficient claim, leave to amend should be denied.

14. Corporations ⟹ 98

The valuation of the worth of a security to be issued is a question on which reasonable persons may differ.

15. Pleading ⟹ 233, 236(2), 241, 251

Notwithstanding that a claim is legally sufficient, leave to amend may be denied where the movant has been unexplainedly dilatory in pursuing discovery and prejudice will result to the defendant.

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

A. Gilchrist Sparks III, Esquire of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for defendant United Technologies Corporation.

Charles S. Crompton, Jr., Esquire, of Potter Anderson & Corroon, Wilmington, Delaware, for defendant Carrier Corporation.

HARTNETT, *Vice-Chancellor*

Plaintiff brought this action on behalf of the minority stockholders of Carrier Corporation ("Carrier") seeking to attack a tender offer

whereby the minority stockholders were cashed out. The action was commenced in 1979. Plaintiff now seeks leave to file a third amended complaint. Defendants oppose the motion claiming that they will be unduly prejudiced by the amendment. The motion for leave to amend must be denied.

I

In this suit plaintiff attacks the validity of a merger between Carrier and United Technologies Holding Corporation ("Holding Corp."), a wholly-owned subsidiary of United Technologies Corporation ("United"). Prior to the merger Carrier was a publicly held Delaware corporation specializing in air conditioning equipment. United is a major diversified industrial corporation which designs, manufacturers and markets a variety of products worldwide. Holding Corp. was a Delaware corporation created by United to hold Carrier voting stock acquired by United.

In November 1978 United Technologies Corporation began a tender offer for Carrier Corporation common and convertible preferred stock. The tender offer was for 17 million shares which gave United approximately 49% of outstanding Carrier voting stock. The offer was $28 per share.

In the Offering Statement United represented that it would propose a merger subsequent to the successful tender offer. The merger was to be a tax-free exchange of Carrier common and convertible preferred stock for a new class of United convertible preferred stock which would be designed to have a value equivalent to $28 per share.

United and Carrier solicited two opinions as to the likely worth of the new convertible preferred shares. Lazard Freres & Co. ("Lazard") gave its opinion that the stock would be worth $28 on a "fully distributed basis". Morgan Stanley & Co. ("Morgan Stanley") opined that the stock was worth $27.25. These opinions predicted a value as of March 30, 1979.

Because of these diverse valuations United asked for informal opinions from three more investment banking houses. One stated that the issue was worth $28 per share as proposed (this proposal was actually less advantageous than the final issue). Another stated that it would be worth $28 per share if the given rate of return were increased (the actual planned dividend was higher than they required). The other banking house was more in line with Morgan Stanley's opinion.

The proxy statement, sent May 30, 1979, included the opinion letters of Lazard and Morgan Stanley, as well as language disclaiming

any assurance that the stock would be worth $28. There was no mention of the three informal opinions.

II

Plaintiff filed his complaint on April 4, 1979 alleging individual and class claims. The original complaint consisted of two counts. One alleged breach of contract by United based upon the tender offer and submissions to minority shareholders at the time of the merger; the other alleged fraud and breach of fiduciary duty to the minority shareholders, as well as a claim that the merger would serve no legitimate business purpose.

In June 1979 the minority shareholders met and voted overwhelmingly in favor of the merger (more than 90% of those who voted approved the merger). As was a prerequisite for approval, more than 50% of the total minority holdings voted in favor of the merger.

In July 1979 plaintiff filed his first amended complaint to assert that the merger had taken place and to add a Count III which challenged actions by Carrier's directors in connection with the United tender offer. Count III was later dismissed without prejudice.

In March 1980 United filed a motion for summary judgment with respect to claims made in the first amended complaint. In June 1980 plaintiff filed a cross motion for leave to file a second amended complaint which added a Count IV containing allegations of non-disclosure and misrepresentations in the proxy materials. It was agreed by stipulation that plaintiff be permitted to file the second amended complaint and that United's pending motion for summary judgment would apply to the new allegations.

[1] On May 12, 1981, I granted summary judgment against plaintiff on Count IV of the second amended complaint and denied summary judgment on Counts I and II on the grounds that issues of fact remained as to whether defendants knew, at the time that the merger was proposed, that the value of the convertible shares could never reach $28 in the foreseeable future and as to whether there was a legitimate business purpose for the merger. *Fisher v. United Technologies*, Del. Ch., C.A. #5847-N.C., Hartnett, V.C. (May 12, 1981).

Plaintiff took no further action in the prosecution of this action for almost a year after my ruling. Then, in April 1982, the Court advised the parties that the case must be actively pursued or it would be dismissed. After this admonition plaintiff seriously began discovery. A document request in April 1979 was his only prior discovery activity. Plaintiff then deposed several people and discovered the so-called

"Sethness Memorandum" of May 22, 1979, in which a ten partner of Morgan Stanley suggested that its valuation of the stock might be lowered to $26.75 and stated that the had contacted several people to discuss the possible necessity for a re-evaluation. Mr. Sethness and all of the people whom his memorandum says he contacted do not now remember discussing the matter.

[2] In February 1983, *Weinberger V. UOP, Inc.*, Del. Supr., 457 A.2d 701 (1983) was decided by the Delaware Supreme Court. It held that a valid business purpose was no longer required as a prerequisite to a cash-out tender offer. As a result, therefore, of my May 1981 granting of partial summary judgment, the only issue remaining in the present lawsuit was whether United knew that the new convertible preferred stock would not, within the foreseeable future, reach a price of $28 per share.

In April 1983, plaintiff filed a motion for leave to file a third amended complaint. In the proposed third amended complaint plaintiff seeks to allege new omissions and misrepresentations in the proxy materials as follows: (1) failure to disclose possible lowered valuation by Morgan Stanley based upon statements contained in the Sethness Memorandum obtained in August 1982 pursuant to a subpoena duces tecum at a deposition of a representative of Morgan Stanley, (2) failure to disclose the definition of "fully distributed basis" in the proxy materials, and (3) failure to disclose the opinions of the three additional investment bankers, in particular the one agreeing with Morgan Stanley, based upon information in the memorandum entitled "Negotiating Committee Events" which was turned over to plaintiff in July of 1979 pursuant to the document request. Needless to say, United opposes plaintiff's motion.

III

[3] Court of Chancery Rule 15(c) provides for the relation back of amendments to a pleading to the date of the original pleading whenever the claims arise out of a "conduct, transaction, or occurrence" which was set forth or which was attempted to be set forth in the original pleading. If I grant plaintiff leave to file his third amended complaint, the claims asserted will relate back to his original complaint and there will not be any possibility that the amendment states a new claim which would be barred by the statute of limitations. This is so because the claims asserted in the proposed third amended complaint concern the Proxy Materials and the propriety of the merger transaction—as did the original complaint and the first and second amended complaints.

IV

[4-8] Court of Chancery Rule 15(a) allows the Court, in its discretion, to permit amendment of pleadings after the pleadings have been closed. As a general rule, leave to amend pleadings should be liberally given. *Foman v. Davis*, 371 U.S. 178, 9 L.Ed.2d 222, 83 S. Ct. 227 (1968); *Gott v. Newark Motors, Inc.*, Del. Super., 267 A.2d 596 (1970). A motion to amend, however, should be made as soon as the necessity for altering the pleadings becomes apparent, but unnecessary delay, where there is neither improper motive on the part of the movant nor undue prejudice to the other party, will not require denial of leave to amend. *Hess v. Carmine*, Del. Super., 396 A.2d 173 (1978). However, in *Denckla v. Independence Foundation*, Del. Supr., 193 A.2d 538 (1963), one of the factors listed by the Court as allowing denial of leave to amend was that the facts upon which the amended complaint was based were known to the plaintiff at or before the time of an earlier amendment. Further, in *Foman v. Davis*, supra, the U.S. Supreme Court stated that the party seeking to amend should give a valid explanation for any neglect or delay.

In the present case plaintiff had both the Proxy Materials and the Negotiating Committee Events memorandum when he was allowed to amend his complaint for the second time in June of 1980 in response to United's motion for summary judgment. Plaintiff could have had the Sethness Memorandum at that time as well if he had chosen to depose the investment bankers earlier in the case instead of waiting more than three years from the commencement of the suit to begin that part of his discovery. Plaintiff gives no reason for the failure to include the omission of the information contained in the Negotiating Committee Events memorandum when he challenged the sufficiency of the proxy materials in his second amended complaint.

As to his failure to question earlier the supposed omission of a definition of "fully distributed basis", the plaintiff claims to have been unaware of its meaning until receipt of a July 8, 1982 affidavit of a member of Lazard defining the term. The plaintiff, however, should have realized his ignorance as to the meaning of this term when he first read the Proxy Materials in 1979, and he could have sought a definition at that time. Plaintiff gives no satisfactory reason for his long delay before beginning to take depositions.

[9] A trial court is not required to allow amendments of pleadings if the party seeking to amend has been inexcusably careless or if unfair prejudice to the other party would result. *Annone v. Kawasaki*, Del. Supr., 316 A.2d 209 (1974). In the present case it would appear that plaintiff has been both inexcusably dilatory in pursuing this case and