Unreported Cases

INTRODUCTION

UNREPORTED CASES is a continuing feature of THE DELAWARE JOURNAL OF CORPORATE LAW. All unreported cases of a corporate nature that have not been published by a reporter system will be included. The court's 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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ANDERSON, CLAYTON & CO. v. QUAKER OATS CO.

No. 925

Court of Chancery of the State of Delaware, Kent

September 26, 1986

Revised September 29, 1986

Plaintiff sought a temporary restraining order enjoining defendant from purchasing or agreeing to purchase for forty-eight hours any stock of plaintiff, pursuant to an order of Chancellor Allen.

The court, per Vice-Chancellor Hartnett, found the language of the order to be ambiguous, and held that plaintiff had not met the heavy burden borne by the party seeking a temporary restraining order. The court expressed its reluctance to interfere in a bidding war which was in the best interests of the corporation's unaligned stockholders. It also emphasized that plaintiff had not shown irreparable harm.

1. Injunction ⟹ 221, 228

In a motion for a temporary restraining order, a party will not be found to be in violation of a prior order where the order is ambiguous, and where the party was not a party to the original order.

2. Injunction ⟹ 137(1), 137(2), 137(4)

Plaintiff bears a heavy burden when seeking a temporary restraining order, and that burden is not met where the motion is based on the alleged violation of an ambiguous order, and where plaintiff has failed to demonstrate irreparable harm if the order is not granted.

Charles F. Richards, Jr., Esquire, of Richards, Layton & Finger, Wilmington, Delaware, for plaintiff.

Lawrence A. Hamermesh, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for defendant.

HARTNETT, *Vice-Chancellor*

Anderson, Clayton & Co., plaintiff, seeks a Temporary Restraining Order against The Quaker Oats Company ("Quaker Oats") to enjoin Quaker Oats for 48 hours from purchasing, or agreeing to purchase, any shares of common stock of plaintiff and seeks to hold defendant in contempt of an Order entered in C.A. #8584-NC (AC Acquisitions Corp., et al v. Anderson, Clayton & Co., et al) on September 19, 1986 by Chancellor Allen.

Unfortunately, Chancellor Allen is now out of the country and I am required to attempt to determine the meaning of the September 19, 1986, Order. The critical language appears in paragraph 7 of that Order which states:

> 7. In the event that plaintiffs do not comply with any and all of the provisions in paragraphs 2 and 6 above and the written commitment filed pursuant thereto in a timely manner, this Order shall be null and void, *ab initio*, and without further order of the Court, *except that neither party shall be permitted to purchase any shares [of Anderson, Clayton & Co.] for a period of 48 hours after plaintiffs' failure to comply.* (emphasis added)

The emphasized language is ambiguous because it may be interpreted to mean that neither party shall be permitted to purchase any shares from any source or it may mean that neither party may be permitted to purchase any shares pursuant to the then pending competing tender offers. To further complicate the matter, Quaker Oats, the defendant in the present case, was not a party in C.A. #8584. Anderson, Clayton & Co. claims however, that Quaker Oats' participation as an observer and as a part owner of AC Acquisitions Corp. (one of the plaintiffs in C.A. #8584) binds it to the September 19, 1986, Order. It is not controverted that Quaker Oats yesterday purchased a number of shares of Anderson, Clayton & Co. on the open market and that such purchase was within 48 hours after Bear, Stearns & Co., Inc. (one of the plaintiffs in C.A. #8584) failed to comply with the September 19, 1986, Order.

[1,2] From the above I find that Anderson, Clayton & Co. has not borne the heavy burden imposed upon one who seeks a temporary restraining order.

Although at some future date Quaker Oats may be found to have violated the September 19, 1986, Order, I cannot find from the present record that this is so.

There is also now under way a bidding war for purchase of shares of Anderson, Clayton & Co. by Quaker Oats and by a third

party—Ralston Purina Co. I am especially reluctant to interfere with an ongoing arms-length bidding war which undoubtedly is in the best interests of the unaligned shareholders of Anderson, Clayton & Co. who are not parties to the litigations which have taken place over the last several months.

Lastly and most importantly, I am not convinced that Anderson, Clayton & Co. will suffer any irreparable harm if this bidding war is permitted to continue unabated.

My decision here is with some reluctance because from the present record it appears that Quaker Oats may not have acted with entire candor but that is a matter to be addressed at some future date.

AUERBACH v. EARTH ENERGY SYSTEMS, INC.

No. 8568

Court of Chancery of the State of Delaware, New Castle

August 19, 1986

Plaintiffs, the trustees of a trust which is a minority shareholder of Earth Energy Systems, Inc. (EESI), commenced this action against EESI, its directors and its controlling shareholder, Control Data Corporation, seeking a temporary restraining order enjoining the proposed sale of substantially all EESI's assets. Plaintiffs contend: (1) the proposed sale violates DEL. CODE ANN. tit. 8, § 271 because the shareholder meeting at which it was approved was not called upon twenty days notice; (2) the proposed sale will violate EESI's obligation of good faith and fair dealing since the plaintiffs' purchased the stock with the reasonable expectation that the assets would not be sold so soon after their acquisition.

The court of chancery, per Vice-Chancellor Jacobs, denied the temporary restraining order, holding: (1) although the shareholder meeting was not called upon the required twenty days notice, the issue is moot since the majority shareholder subsequently executed a valid written consent, pursuant to DEL. CODE ANN. tit. 8, § 228, authorizing the proposed sale; (2) plaintiffs failed to produce evidence

establishing that EESI was obligated not to sell its assets within a specified period. In the absence of a clear contractual obligation, the propriety of such a decision is measured under the business judgment rule and will not be addressed in this stage of the proceeding.

1. Injunction ⟹ 136(1)

To become entitled to a temporary restraining order, the moving party must establish, with due allowance for the limited opportunity to develop a record at that stage, a reasonable probability of success on the merits, a likelihood of irreparable injury if injunctive relief is not granted, and a balance of hardships that favors the moving party.

2. Injunctions ⟹ 70, 137(1)

Corporations ⟹ 182.4(1), 182.4(3), 182.4(4), 192, 194

Where a shareholders' meeting, in which it was voted to sell all of a corporations' assets, was called upon only days notice, but the majority shareholder subsequently executed written consent authorizing the proposed sale, there was insufficient record evidence to justify an order temporarily restraining the corporation from completing the transaction. DEL. CODE ANN. tit. 8, §§ 228, 271 (1983).

3. Corporations ⟹ 182.3, 182.4(1), 182.4(3), 182.4(4), 194

The use of defendant majority shareholder's written consent to authorize the sale of all a corporation's assets did not constitute inequitable conduct invalidating such consent, where the consent, executed pursuant to Delaware statute, merely confirmed the results of the previous day's stockholder meeting, and was employed to obviate the risk that the meeting was invalid due to insufficient notice. DEL. CODE ANN. tit. 8, § 228 (1983).

4. Injunction ⟹ 72

Corporations ⟹ 182.3, 182.4(1), 182.4(3), 182.4(4)

Where the record is expedited and the facts indicate the directors have been continually advised of the sale, the question of due care

is appropriately left for a later stage of the proceeding rather than one seeking a temporary restraining order.

5. Injunction ⟹ 72

Corporations ⟹ 182.3, 182.4(1), 182.4(4)

Absent a clear contractual provision or more convincing evidence, the directors are empowered to propose a sale of assets if done in their good faith business judgment and a court will not issue a temporary restraining order against the sale.

6. Injunction ⟹ 14, 72, 137(1)

Corporations ⟹ 182.4(1), 182.4(2), 182.4(4)

Plaintiff minority shareholder seeking a temporary restraining order failed to establish irreparable harm resulting from a corporation's sale of its assets where the record indicates the sale occurred in an arms-length transaction in which the corporation will obtain the fair value of the assets and plaintiff is no worse off than before the sale.

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

Louis J. Finger, Esquire, and E. Norman Veasey, Esquire, of Richards, Layton, & Finger, Wilmington, Delaware, for defendant.

JACOBS, *Vice-Chancellor*

The plaintiffs, who are trustees of a trust that holds 212,500 shares (approximately 13.7%) of common stock of Earth Energy Systems, Inc., a Delaware corporation ("EESI"), commenced this action on August 11, 1986 against EESI, its directors, and its 74.7% controlling stockholder, Control Data Corporation ("Control Data"). The plaintiffs seek to enjoin a proposed sale of assets of EESI's WINCO Division ("the WINCO" sale), including assets held by EESI's 100% owned subsidiary, Dyna Technology, Inc. ("Dyna"), to Energx Corporation ("Energx"). Presently pending is the plaintiff's motion for a temporary restraining order prohibiting the defend-

ants from consummating the WINCO sale. Although that sale was scheduled to close on Friday, August 15, 1986, at 1:00 p.m., the defendants and Energx have agreed to postpone the sale to Tuesday, August 19, 1986. This is the decision of the Court on the plaintiffs' motion for a temporary restraining order.

I.

A recital of certain background facts is useful to an understanding of the contentions plaintiffs are advancing. EESI is a Delaware corporation formed in 1980 under the name of "Jacobs Wind Electric Company", as a joint venture between the Jacobs family (no relation to the undersigned) and Control Data to succeed to the 60-year-old Jacobs Wind Turbine business. EESI's operations are divided into two divisions. The WINCO Division consists of the manufacturing of electric generators. The "WINDPARKS" Division manages and operates "Windparks", which generate electrical power through the use of windmills. Most, if not all, of the assets of the WINCO Division are held by EESI's wholly-owned subsidiary, Dyna, which was acquired from Keystone Camera Products Corporation ("Keystone") in 1985. Control Data owns 74.7% of EESI's outstanding voting stock, various public shareholders own 11.6%, and plaintiffs own approximately 13.7%.

Critical to an understanding of this case is the history of how Dyna came to be sold to EESI and how plaintiffs came to be EESI shareholders. In 1985 Keystone, of which the plaintiff Mark Auerbach is president and chief executive officer, sold its Dyna stock to EESI. The consideration was $3.5 million, consisting of $1.75 million cash, $1.75 million in the form of 218,750 shares of EESI stock, and a Put Option Agreement dated February 6, 1985.[1] Under the Put Option Agreement, Keystone has the right to require EESI to repurchase for cash up to $500,000 worth of its shares from Keystone. The option is exercisable on February 6, 1987 as to $250,000 worth of EESI stock, and on February 6, 1988 as to the balance. Keystone has given notice to EESI of its intent to exercise the Put Option. The effect of that Option is to enable Keystone to realize up to

1. Under the Keystone/EESI stock purchase agreement, Keystone has the right, so long as it owns at least 50,000 shares of EESI, to designate one director to sit on EESI's Board of Directors. Plaintiff Auerbach was designated as Keystone's representative on EESI's four-member Board (the remaining 3 members being Control Data designees) and now serves in that capacity.

$500,000 in additional cash for a portion of its EESI stock, yet also to retain a substantial amount of EESI shares.

Thereafter, pursuant to the Closing Agreement entered into by the parties in connection with the 1985 Dyna sale, Keystone assigned the proceeds of the sale (including the EESI stock and the Put Option) to the plaintiffs as trustees under a trust agreement dated December 31, 1983. Thus, the plaintiffs stand in the shoes of Keystone in its capacity as holder of both the EESI stock and the Put Option received in the 1985 sale of Dyna to EESI. The foregoing facts are significant because the plaintiffs claim that in determining to enter into the Dyna sale, Keystone relied upon two EESI documents: a September 7, 1984 EESI Private Placement Memorandum and an August 30, 1984 Five Year Business Plan. The Private Placement Memorandum is claimed to have outlined a strategy for EESI to become a leader in providing energy sources as alternatives to traditional fossil fuels. That strategy included the marketing and syndication of windfarms that would use EESI's turbines, electrical generators, and related equipment manufactured by Dyna. The windfarms would involve configuring wind turbines so that they could serve the electrical needs of businesses and enable bulk power to be sold to electrical utilities. The Private Placement Memorandum and Five Year Business Plan projected that EESI would derive increasing multimillion dollar revenues from windfarm sales and operations.

Despite the rosy predictions contained in those documents, subsequent events conspired to jeopardize the venture almost from the beginning. Both EESI and Control Data experienced significant financial difficulties, and the economic conditions which made the windpark concept attractive in 1985 suffered reverses due to significant adverse changes in the economy. In 1984 and in early 1985 all the electrical power that EESI's Windparks Division could produce was being sold to utilities at favorable prices. Because of investment and energy tax credits, windparks were an attractive tax shelter investment. During 1985, however, oil prices plummeted and it became less expensive for utilities to produce electricity with oil and gas. As a result, the revenues paid by utilities to the windparks dropped. The high value of the United States dollar made it difficult for the WINCO Division to compete with foreign competition, and the available investment and energy tax credits were being legislatively reviewed and revised. These developments made windpark investments less favorable. Moreover, a major supplier of turbines for a project managed by EESI filed for Chapter XI Bankruptcy.

Because of those events, EESI and its divisions experienced substantial operating losses as of December 31, 1985 and a net operating loss of over $5 million (of which $932,000 was allocable to the WINCO Division) for the six-month period ending June 30, 1986. At present, EESI is losing over $1 million per month and its projected net loss for the year could be as high as $13 million. EESI's management believes that the WINCO Division will lose $2.6 million for the year ending December 31, 1986 if it remains an asset of EESI.

Recognizing that EESI had to take steps to reduce the substantial losses that were mounting each month, the Board of Directors, at a meeting held on December 5, 1985, authorized EESI (over Auerbach's dissent) to seek a buyer for the WINCO Division (*i.e.*, the assets held by Dyna). Over the next several months EESI engaged in extensive efforts to find a buyer for its WINCO Division, including approaching 21 companies in an effort to elicit offers.[2] Only two offers were received. One of the two offerors withdrew because of its inability to obtain adequate financing, which left only one offeror, Zaidan International ("Zaidan") in the field. On May 22, 1986, EESI and Zaidan executed a letter of intent which contemplated a sale to Zaidan of "substantially all of the assets of EESI's WINCO Division", subject to a definitive asset purchase agreement. The purchase price was to be the net book value of WINCO's assets, less certain liabilities being assumed by the purchaser (including indebtedness to Control Data) less a 25 percent discount on the net value (*i.e.*, assets less assumed liabilities). Thereafter, EESI and Zaidan negotiated a 47-page Asset Purchase Agreement, which was executed on July 31, 1986. Under that Agreement the purchaser is Energx, a Minnesota corporation apparently created by and affiliated with Zaidan for the purpose of acquiring the WINCO assets. Although it has received approval by EESI's directors and shareholders, the Asset Purchase Agreement is still being revised as to details. For example, the parties to the Agreement (EESI and Energx) have agreed that the subordinated promissory note which forms part of the consideration for the sale will be paid directly to EESI, rather than to Control Data as previously agreed.[3]

On its merits the WINCO sale has been controversial from the

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2. The record indicates that Auerbach was involved in this process and suggested additional potential purchasers to management.

3. Apparently the promissory note was to run in favor of Control Data, in connection with the Energx assumption of EESI's indebtedness to Control Data.

outset. At the special stockholders' meeting held on August 12, 1986, the sale was approved essentially by the 74.7% vote of EESI's majority stockholder, Control Data. Only two minority shareholders (representing 600 shares) joined Control Data in approving the WINCO sale. The remainder of the minority stockholders—including EESI's former Chairman and President—voted against it.

The record indicates that Auerbach was kept advised of EESI's efforts to sell the WINCO assets, was informed of the May 22, 1986 letter of intent agreement with Zaidan in early June 1986, and was furnished a copy of the July 31, 1986 Asset Purchase Agreement on August 5, 1986. Auerbach and his co-plaintiff, Robert Clarke, brought this action to enjoin the sale on August 11, 1986.

II.

[1] To become entitled to a temporary restraining order, the moving party must establish (with due allowance for the limited opportunity to develop a record at that stage) a reasonable probability of success on the merits, a likelihood of irreparable injury if injunctive relief is not granted, and a balance of hardships that favors the moving party. *Hecco Ventures v. Sea-Land Corporation*, Del. Ch., C.A. No. 8486, Jacobs, V.C. (May 19, 1986); *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, Del. Supr., 506 A.2d 173, 179 (1986).

The plaintiffs rest their application for temporary injunctive relief upon two distinct claims. The first is that the WINCO sale is a sale of "all or substantially all" of the assets of EESI which, under 8 *Del.C.* §271, requires shareholder approval "at a meeting duly called upon 20 days' notice." Plaintiffs claim that 271 was violated, because the August 12, 1986 meeting at which the WINCO sale was approved was held on 12 days' notice rather than on the 20 days' notice prescribed by the statute. Plaintiffs' second contention is that the proposed sale of the WINCO Division will violate EESI's obligation of good faith and fair dealing under the Stock Purchase Agreement, Put Option Agreement and Closing Agreement entered into by Keystone in connection with its sale of Dyna to EESI in 1985. Plaintiffs argue that by virtue of the Private Placement Memorandum and the Five Year Plan, Keystone and plaintiffs had the reasonable expectation that the electric generator manufacturing operation would remain a part of EESI, and that the business would not be sold 18 months later, leaving plaintiffs as stockholders in a company with no viable ongoing business and whose only operations were abandoned windfarm projects and windfarms that are creating large losses. Specifically, it is argued that (i) the WINCO sale violates the parties'

fundamental expectations of the purpose of the Dyna sale and the spirit of their bargain, (ii) the WINCO sale will render their contractual rights under the Put Option worthless by disposing of EESI's only income producing assets at the insistence and for the benefit of Control Data, and (iii) unless the WINCO sale is enjoined, the plaintiffs will suffer irreparable harm because, *inter alia*, it will leave EESI with a substantial negative net worth, with no viable business, and unable to respond to any money judgment entered in the plaintiffs' favor.

For the reasons now discussed, I conclude that the plaintiffs have not established their entitlement to the temporary injunctive relief that they seek.[4]

[2] At the time this action was filed, the plaintiffs' claim that the WINCO sale would violate 8 *Del.C.* § 271 afforded ample cause for concern. Although the defendants contended otherwise, the evidence strongly suggests that the WINCO Division represents "all or substantially all" of EESI's assets. And the stockholders' meeting to approve the sale was clearly called on less than the 20 days' notice mandated by 271. However, shortly before oral argument, the defendants advised the Court that on August 13, 1986, Control Data, as EESI's majority stockholder, had executed a written consent under 8 *Del.C.* §228 authorizing the transaction. The defendants contended that as a result of that written consent, the plaintiffs' contentions based upon 8 *Del.C.* §271 had become moot.

At oral argument plaintiffs' counsel conceded that the written consent would moot their claim under 8 *Del.C.* §271, provided that the consent were valid. Plaintiffs contend, however, that the consent is not valid because (a) it represents an inequitable and belated manipulation of the corporate machinery, (b) the consent is insufficient under §271, because, the WINCO assets are held by Dyna, and, therefore, a separate vote by EESI as Dyna's sole stockholder and a separate resolution by Dyna's Board of Directors approving the sale of Dyna's assets, were required, and (c) even though the directors of EESI passed a resolution approving the WINCO sale, in fact they did not and could not have approved it, because a majority of the Board never saw the definitive Asset Purchase Agreement, the exhibits showing the assets to be sold and the liabilities

4. Because of the disposition of plaintiffs' 271 and implied contract claims, it is unnecessary to deal with their additional claims of tortious interference and conspiracy, the latter being necessarily dependent for their validity upon the former.

to be assumed were not in existence, and the Agreement is still in the process of being negotiated. Having reviewed the rather limited record in this expedited matter, I conclude, albeit with reluctance, that while the manner in which this sale is being conducted leaves something to be desired from a procedural standpoint, nonetheless the evidence relating to plaintiffs' §271 claim is insufficient to justify the intervention of this Court at this time.

[3] To begin with, there is no evidence that the 228 consent represents inequitable conduct on the defendants' part. The defendants could (if they so chose) have followed the 8 *Del.C.* §228 written consent procedure from the outset. The written consent merely confirmed the results of the stockholders' meeting which had taken place the day before, and was employed to obviate any risk that the stockholders' meeting might be invalidated on grounds of insufficient notice.

The plaintiffs's second challenge—based upon the absence of separate resolutions by EESI and by Dyna's Board of Directors approving the sale of Dyna's assets—is more perplexing. On the one hand, §271 on its face, does call for such approvals. On the other hand, as a practical matter, the approvals would amount in this case to a formality, since, as defendants point out, EESI is Dyna's 100% stockholder and could easily direct Dyna's Board of Directors to authorize the necessary resolutions. Defendants argue that since EESI's directors and stockholders have already approved the sale, those approvals should be deemed to include Dyna as well as EESI.[5] Moreover, since only EESI is a stockholder of Dyna, there is a question as to the plaintiffs' standing to challenge a sale of Dyna's assets under 271. *See Lewis v. Anderson*, Del. Supr., 477 A.2d 1040 (1984). However, it is unnecessary to decide these questions. After oral argument the defendants' counsel advised the Court that before the closing of the sale, a Board of Directors' meeting of EESI would be convened at which a new Board of Directors of Dyna would be elected, and that Board would thereafter approve the asset sale on Dyna's behalf. Counsel thereafter confirmed that those corporate actions were taken on August 18, 1986. As a result, plaintiffs' second challenge to the written consent must be considered moot.

[4] The defendants' last challenge to the written consent—that EESI's directors did not and could not have approved the sale—is

5. Since Dyna was sold to EESI in 1985, Dyna has had no independent Board of Directors; instead, EESI's directors have acted as the *de facto* directors of Dyna.

not adequately supported by the record. Mr. Auerbach's affidavit indicates that at the time of the EESI directors meeting, a majority of the directors had not even seen the July 31, 1986 Asset Purchase Agreement. Further, the defendants have admitted that certain terms of the Agreement are still being negotiated. While those facts have a certain disconcerting aspect, they must be evaluated, on this extremely expedited record, in the light of evidence that the directors of EESI have been and are being kept continually advised of the terms of the WINCO sale as those terms continue to evolve. Moreover, counsel for defendants has represented that at the August 18 meeting of EESI's directors, the directors ratified and confirmed their prior approvals of the asset sale on behalf of EESI. Accordingly, the thrust of plaintiffs' contentions is not the fact of whether the proposed asset sale has been approved by EESI's directors, but rather the degree of care with which those approvals were conferred. The question of due care is more appropriately reserved for a later stage of this proceeding.

[5] Plaintiffs' second claim, based upon the defendants' alleged breach of their implied contractual duty to deal fairly and act in good faith, is likewise insufficient to support a grant of temporary injunctive relief. To begin with, the record does not support it. What plaintiffs are arguing is that Keystone's bargain, in essence, was that Dyna's assets would not be sold so soon after their acquisition by EESI, and/or would not be sold under circumstances that would leave EESI incapable of fulfilling its obligations under the Put Option. However, nothing in the contract documents explicitly obligates EESI to hold, and not to sell, the WINCO assets for any specific period of time. Moreover, it is not disputed that EESI's directors are empowered to propose a sale of corporate assets if, in their honest, good faith business judgment, such a sale is necessary to extricate the corporation from a perilous financial crisis such as that EESI faces here. Absent a clear contractual provision prohibiting EESI's directors from doing what they would otherwise be legally empowered to do, to imply such a prohibition judicially would require much more convincing evidence than has been developed on this record so far. On the present record, and recognizing fully the possibility that on a more expanded record a different conclusion might be reached,[6] there is no sufficient basis for implying a contractual condition, the effect of which would be to prohibit EESI from selling

6. With respect to this particular claim, it must be observed that the plaintiffs were not without opportunity to develop a fuller record. Since early June, 1986

its assets under circumstances where such a step would otherwise be justified in the directors' honest, good faith business judgment.

[6] Finally, even if the WINCO sale is assumed to be a violation of defendants' duty of fair dealing, plaintiffs have not established the likelihood that they will be irreparably harmed by the sale. The present record does not indicate that the WINCO sale is other than an arm's-length transaction that will result in EESI obtaining fair value for the assets being sold. If that is the case, then plaintiffs are no worse off economically than they were before the sale, as far as their status as EESI stockholder and Put Option holder is concerned. To the extent plaintiffs claim irreparable harm because the sale will leave ESSI with a negative net worth, in that respect the sale would have no adverse impact, because EESI already has a negative net worth. Moreover, if fair value for the assets is not received and if that is shown to be caused by the defendants' wrongful conduct, the plaintiffs will have an adequate remedy in damages.[7]

* * *

For the foregoing reasons, plaintiffs' application for a temporary restraining order is denied. IT IS SO ORDERED.

DEBBS v. BERMAN

No. 7973

Court of Chancery of the State of Delaware, New Castle

August 1, 1986

In a prior action, plaintiffs, the Debbs, alleged and proved that they were fifty percent stockholders of Cubkins, Inc. and obtained

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the plaintiffs have known (as a result of the EESI/Zaidan letter of intent) of EESI's plans to sell the WINCO assets, yet they chose not to bring this action until August 11, 1986. Any procedural disadvantages this delay has caused have been inflicted by the plaintiffs upon themselves. *See Hecco Ventures v. Sea-Land Corporation, supra*, at p. 12; *Bacine v. Scharffenberger*, Del. Ch., C.A. No. 7862, Brown, C. (December 10, 1984), at pp. 9-10.

7. The most recent Form 10Q filed by Control Data with the Securities and Exchange Commission shows that Control Data has stockholder equity totalling over $1.1 billion. The maximum damage claim under the Put Option is $500,000.

a consent order requiring the defendants, the Bermans, to account for and pay to plaintiffs their share of profits from said corporation. In this action, plaintiffs now move for entry of judgment in their favor in the amount of $414,908.21, plus interest and costs, and for an order holding defendants in contempt of the original consent order.

The court of chancery, per Vice-Chancellor Berger, held that even though the defendants' accounting was unacceptable to the court, the defendants had not violated the consent order and denied the motion for contempt.

1. Account ⟹ 17(5)

In an action for contempt of court, once the plaintiffs have alleged and proven a claim for an equitable accounting, the burden of proof rests with the defendants.

2. Account ⟹ 22

When the court rejects the defendant's purported accounting, it becomes necessary to find an alternative and equitable method of computing the judgment award; and computation based upon after-tax profit per manufactured item is such a method.

David A. Drexler, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for plaintiffs.

Michael S. Purzycki, Esquire, and James S. Green, Esquire, of Connolly, Bove, Lodge & Hutz, Wilmington, Delaware, for defendants.

BERGER, *Vice-Chancellor*

By opinion dated January 29, 1986, this Court decided that plaintiffs, Lynn and J. Robert Debbs, are fifty percent stockholders of Cubkins, Inc. ("Cubkins") and that Cubkins owns the exclusive right to manufacture and sell a novelty item called the "Bear-In-A-Ball" ("Bear"). In order to place the present applications in perspective, it is helpful to summarize the parties' business relationship. Cubkins was incorporated in the spring of 1984, when Lynn Debbs and defendant, Del Berman, began their business venture. Although Del Berman claimed to be the company's sole stockholder, it has

been determined that she, either individually or with her husband, Lawrence Berman, owns only a fifty percent interest in Cubkins. Lynn Debbs was involved in the day-to-day operations of Cubkins until February or March of 1985, at which time plaintiffs were excluded from any further participation in the business. Plaintiffs filed suit in mid-March, 1985, and at about the same time defendants began manufacturing and selling Bears through another corporate entity—Hang It Up, Inc. ("Hang It Up"). A short time later, Lynn Debbs began producing and marketing Bears through her own business—Creative Urge.

Following the decision referred to above, Del and Lawrence Berman were ordered to:

> (a) Forthwith account for and pay to Cubkins, Inc. all profits and assets derived from the manufacture and sale of the novelty item known as the "Bear-In-A-Ball" since April 1, 1984, in no matter what corporate name or entity said "Bears-In-A-Ball" were manufactured and sold; and (b) forthwith cause Cubkins, Inc. to pay to plaintiffs an amount in cash equal to the sum of all amounts paid to or for the benefit of defendants, whether by way of distributions, salaries, loans, fringe benefits, or other forms of emolument, from proceeds derived from the sales of "Bears-In-A-Ball," subject only to a credit for all amounts heretofore paid by Cubkins, Inc. to plaintiffs. Judgment Order, ¶4 (March 19, 1986).

Plaintiffs moved for entry of judgment against defendants in the amount of $414,908.21, with interest from March 19, 1986, together with the costs of this action. In addition, plaintiffs moved for an order holding defendants in contempt of a Consent Order dated May 1, 1985, and imposing sanctions as the Court deems appropriate. The relevant paragraph of the Consent Order provides:

> 2. Defendants shall maintain separate books and records and segregate all funds received with respect to all business conducted with respect to "Bears-In-A-Ball" pending final disposition of this action and no distributions of profit shall be made to any person pending agreement of the parties or further order of this Court. Consent Order, ¶2 (May 1, 1985).

Defendants maintain that plaintiffs are entitled to a judgment in the amount of only $27,008 and that a finding of contempt would be

inappropriate because they have never intentionally violated the terms of the Consent Order. This is the decision, following an evidentiary hearing, on the pending motions.

The first issue to be decided with respect to the accounting is the allocation of the burden of proof. Plaintiffs argue that, under settled law, the party rendering an account has the burden of proving its accuracy and the propriety of the transactions reflected therein. *See*, 1 Am. Jur. 2d, *Accounts and Accountings*, 63; *Thamert v. Carter*, Idaho Supr., 245 P.2d 145 (1952). Defendants take the opposite view, relying upon *Levien v. Sinclair Oil Corporation*, Del. Ch., 300 A.2d 28 (1972) for the proposition that even though defendants may be required to account for damages, plaintiffs still have the burden of proving those damages.

Levien was a derivative action brought by a minority stockholder of a subsidiary of Sinclair Oil Corporation ("Sinclair") in which Sinclair was held liable for breaching a contract with the subsidiary. An order was entered requiring Sinclair to "account to" the subsidiary for the damages sustained as a result of the breach. Sinclair seized upon the term "account to" and argued that plaintiff should be required to follow the procedures fixed by the Chancery Court Rules for excepting to the accounts of a trustee or guardian. The *Levien* Court rejected Sinclair's position, holding that the words "account to" had been used in the broad sense of "pay" and did not indicate that the action was one for an equitable accounting. The underlying claim was an action for damages for breach of contract and the Court found no basis for proceeding other than in the ordinary manner of a trial for damages. Significantly, the Court noted that there may be cases where an accounting is appropriate based upon the nature of the claimed wrong. *Id.* at 30.

[1] By contrast to *Levien*, plaintiffs here were not claiming damages for breach of contract. Rather, they alleged and proved that they have a fifty percent interest in the business of Cubkins. They also alleged, and defendants admitted, that defendants had direct supervision and control of Cubkins' books, records, funds and operations and owed fiduciary duties to plaintiffs. The Court found, as alleged, that defendants failed to maintain accurate books and records and, as requested in plaintiffs' prayers for relief, ordered defendants to account for all profits and assets derived from the manufacture and sale of the Bears. Thus, plaintiffs have alleged and proven a claim for an equitable accounting, *see*, *Pan American Trade and Investment Corp. v. Commercial Metals Co.*, Del. Ch., 94 A.2d 700,

701 (1953); 1 Am. Jur. 2d *Accounts and Accounting* §§44, 45, and the burden of proof rests with defendants.

Defendants rely primarily on three financial statements in support of their position as to the amount owed plaintiffs: (1) a certified audit of Cubkins for the twelve months ended March 31, 1985, prepared by Daniel Caputo, C.P.A. (the "Caputo audit"); (2) a compilation of Cubkins' assets and liabilities and revenues and expenses on an income tax basis for the thirteen months ended April 30, 1986, prepared by the accounting firm of Zenker and Styer, P.A. (the "Cubkins' compilation"); and (3) a review of Hang It Up's assets and liabilities and revenues and expenses on an income tax basis for the thirteen months ended April 30, 1986, also prepared by Zenker and Styer, P.A. (the "Hang It Up review"). The Caputo audit shows net profits of $223,070 on sales of $754,540. The Cubkins compilation shows a net loss of $31,967 on no sales and the Hang It Up review shows net profits of $5,205 on sales of $759,248.

Defendants made several upward adjustments to these figures in calculating the amounts subject to distribution and then reduced the balance due by those amounts purportedly already paid to plaintiffs and the amount due from plaintiffs to defendants for plaintiffs' independent sale of Bears. Specifically, defendants increased Cubkins' net income by $7,000, the amount they estimate Cubkins paid in attorneys' fees pertaining to this litigation. This adjustment was made because, in defendants' view, each party should bear its own litigation costs and expenses. Legal fees in the amount of $23,763 likewise were eliminated from Hang It Up's statement of operating expenses. Other adjustments were made to eliminate all of the depreciation shown on Hang It Up's financial statements as well as a portion of the expenses charged for advertising, travel and entertainment and a consultant's fee. These adjustments resulted in a $76,887 increase in the net income of the two companies. By defendants' calculations, plaintiffs' share of the net profits is $127,390 from which $88,000 is deducted for amounts previously paid to plaintiffs and $12,382 is deducted for plaintiffs' profits on their independent sales of Bears.

Plaintiffs urge the Court to reject defendants' figures for either of two reasons. First, they argue that the Cubkins compilation and Hang It Up review have no independent reliability because they are nothing more than recapitulations of data furnished to the accounting firm by defendants. They argue that the enormous disparity between the operating results for the first year and the second thirteen months on its face suggests that the unaudited financial statements are in-

accurate. In addition, they focus on the impropriety of particular expenditures which, plaintiffs contend, taint the entire accounting. Alternatively, plaintiffs argue that they are entitled to the profits they would have made on the sale of the Bears even if defendants' profits were considerably lower.

Based upon the evidence presented at the hearing, I am convinced that defendants have not met their burden of providing an accurate accounting of the operations of Cubkins and Hang It Up. Turning first to the Cubkins compilation, it shows operating expenses of slightly more than $64,000 with the only revenues being $275 in interest income. Mr. Vincelette, the employee of Zenker and Styer, P.A., who prepared the compilation, explained the absence of any sales revenues by the fact that Cubkins was not engaged in the production or sale of Bears during the period covered by the compilation. He testified that the expenses were incurred in attempting to collect outstanding accounts receivable.

When questioned as to whether any of Cubkins' stated expenses actually were those of the Bermans' new company—Hang It Up, Mr. Vincelette responded that the two companies' books were kept totally separate and that there was no commingling between Cubkins and Hang It Up. However, none of defendants' witnesses were able to explain how the purchase of a portable refrigerator, expenses incurred in attending a trade show or various shipping charges, all paid by Cubkins, related to the collection of outstanding accounts receivable.

It is apparent from the types of expenses charged to Cubkins that defendants charged Hang It Up's expenses to Cubkins until Cubkins' assets were depleted. Mrs. Barba, the office manager and bookkeeper for both companies, would not concede this point. However, she acknowledged that she took a very broad view of the term "collections" and indicated a certain indifference to the allocation of expenses. She commented, "[w]hether or not it was an expense of Cubkins or Hang It Up, it was still for the Bear-In-A-Ball." (Trans., p. 88.) Thus, at a time when Del Berman was taking the position that she was free to market the Bears through a separate company without any duty to account to plaintiffs, the evidence indicates that the expenses of her separate company were being charged to Cubkins. As it turns out, the fact that defendants charged Hang It Up expenses to Cubkins will not affect defendants' ultimate liability. However, it does raise serious questions as to the manner in which defendants kept their books since, at the time those expenses

were charged to Cubkins, it was in defendants' interest to minimize Cubkins' net profits and maximize those of Hang It Up.

In addition, the evidence presented by defendants was insufficient to justify the stated revenues of Hang It Up or various expenses claimed by both companies. On the revenue side, both Cubkins and Hang It Up showed sales of approximately $750,000 for approximately 300,000 Bears. Cubkins was sellings its Bears for $2.50 each and the numbers work out at that price. However, the evidence showed that Hang It Up sold some of its Bears at $3.00 each. There was no evidence presented to the Court as to the number of Bears Hang It Up sold at the higher price, but even if only 20% of Hang It Up's sales were at $3.00 per Bear, its sales revenue should have been increased by $30,000.

Turning to expenses, Hang It Up listed slightly under $15,000 in travel and entertainment expenses for the 13 months ended April 30, 1986, as compared with slightly under $2,000 charged to Cubkins the previous year. Approximately $2,500 of those travel and entertainment expenses were checks drawn to cash or the Bermans without any receipts or supporting data other than handwritten notes. One such note accompanied a $2,000 check made out to cash and read, "Florida travel expenses." In addition, approximately $2,300 was paid to Del Berman's Visa account. One such payment, in the amount of $500, is explained by the note "gas and several business meals" but the accompanying Visa statement shows less than $100 in charges to gas companies and restaurants. Other expenses paid by Hang It Up and charged either to travel and entertainment or advertising included $780.00 for four tickets to a Bruce Springstein concert attended by the Bermans and the Barbas as a birthday celebration; $1,500 paid to Lawrence Berman's business for music boxes given as Christmas gifts to employees; approximately $1,000 in travel and food expenses charged to advertising; and approximately $1,500 in additional Visa payments charged to advertising. Other items of at least questionable validity include $1,395 charged to furniture and equipment for the purchase of a video camera and consultant's fees in the amount of $41,665.

As noted earlier, defendants made voluntary adjustments to the expenses listed for travel and entertainment, advertising, legal fees and the consultant's fee in computing the amount they claim is due plaintiffs. They take the position that these adjustments are more than generous and eliminate any quarrels plaintiffs may have as to the propriety of some of these expenditures or the absence of supporting documentation.

However, the fact that defendants were willing to make certain allowances on the more obvious items, such as payments made to cash and to the Bermans without independent evidence of the validity of those payments, does not mean that the remainder of the figures submitted by defendants should be accepted on their face. There remain questions as to why there were approximately threefold increases in such items as office expenses, rent and telephone and why operating expenses as a whole doubled and the cost of goods sold increased by more than 40%. Since the 1986 financial statements for Cubkins and Hang It Up were not audited statements and various expenses highlighted above were not supported or were inaccurately recorded, I conclude that the figures relied upon by defendants are not reliable and cannot be used to determine the amount due plaintiffs. *See: Simper v. Scorup*, Utah Supr., 1 P.2d 941 (1931); *Adolph Gottscho, Inc. v. American Marking Corp.*, N. J. Supr., 139 A.2d 281 (1958).

[2] Having rejected defendants' purported accounting, it becomes necessary to find an alternative and equitable method of computing the judgment award. *See, Simper v. Scorup*, 1 P.2d 941. Plaintiffs urge the Court to base its computation on a pre-tax profit per bear of $1.10. The proposed profit per Bear is the lower end of the range of profits projected by Del Berman before Cubkins began operations and is consistent with plaintiffs' experience in selling Bears after April 1, 1985, as well as Cubkins' experience for the year ended March 31, 1985.

After considering all of the evidence, I conclude that the award should be computed on the basis of an after-tax profit of $.74 per Bear. Del Berman's initial projections are of little value at this point given the fact that there are actual operating results from which to work. Plaintiffs' operating results are also of limited assistance inasmuch as plaintiffs have been operating on a very small scale out of their own house. Lynn Debbs acknowledged that, in computing her profit figure, she did not charge for the business use of a portion of her house, car, telephone or other similar expenses. Thus, plaintiffs' profits are not an appropriate measure of the profits of Cubkins or Hang It Up. I find Cubkins' audited financials to be the best evidence of the Bears' profitability. The audit shows pre-tax profits of $.92 per Bear and after-tax profits of $.74 per Bear. The computation, based upon a total of 715,000 Bears is as follows:

No. of Bears	x	Profit	x	Debbs' Share	
100,000	x	$.74	x	.40	= $ 29,600
615,000	x	$.74	x	.50	= $227,500
			TOTAL		$257,150
		Less Amounts Paid*			(79,893)
					$177,257
		Less Credit for 29,482 Bears sold by Debbs			(10,908.34)
					$166,348.66

Plaintiffs also ask for attorneys' fees in the amount of $108,034.21 whereas defendants argue that the parties should bear their own attorneys' fees. Since the parties have not submitted any authority in support of their positions on attorneys' fees, I will defer ruling on plaintiffs' application until such time as they have submitted a memorandum in support thereof and defendants have had an opportunity to respond.

With respect to the contempt motion, Del Berman conceded that she transferred cash and inventory from Cubkins to Hang It Up after the Consent Order was entered. However, in her view, those transfers did not violate the Consent Order. Del Berman understood that she was not allowed to transfer any funds directly to her or her husband. However, she knew that a portion of Cubkins' profits would be due to her even if plaintiffs prevailed on their claim. Accordingly, Del Berman transferred the money that would be due to her from Cubkins—approximately $60,000—to Hang It Up. Based upon this testimony as well as the evidence, discussed earlier, that Hang It Up expenses were charged to Cubkins, there can be no question but that defendants did not maintain separate books and records and segregate all funds as between the two companies.

The language of the Consent Order, although arguably intended to prevent the type of commingling that occurred here, does not expressly require defendants to maintain separate books and records

* Defendants contend that $88,000.00 has been paid to plaintiffs. However, I accept as accurate the amount stated in Lynn Debbs' affidavit, as adjusted by a later payment of $20,000.00.

and segregate funds for the two businesses engaged in the production and sale of Bears. Since there is no evidence that any of the commingling involved businesses which were engaged in activities other than the sale of Bears, I conclude that plaintiffs' contempt motion must be denied.

I request that counsel for plaintiffs submit a form of order, on notice, in accordance with this decision. I note that the parties took no position as to the appropriate rate of interest to be included in the Judgment Order. If the parties are unable to agree as to the appropriate interest rate, an office conference will be scheduled shortly after the form of order is submitted to the Court.

IN RE ENSTAR CORP.

No. 7802

Court of Chancery of the State of Delaware, New Castle

July 17, 1986

Plaintiffs, stockholders of defendant, contest defendant's refusal to comply with plaintiffs' demand for appraisal of stock owned beneficially by them. The shares were shown on defendant's records as owned by CEDE & Co. CEDE & Co. is the nominee of The Depository Trust Company to hold securities for brokerage firms, banks and other financial institutions on behalf of the customers of these entities.

The court of chancery, per Vice-Chancellor Hartnett, held that plaintiffs must be accorded their appraisal rights because (1) defendants knew that many of their shares were held beneficially by CEDE & Co. and (2) defendant's proxy detailing the procedures necessary for exercise of the appraisal rights did not make mention of CEDE & Co. by plaintiffs mandatory.

1. Corporations ⟹ 584

At common law there was no provision for an appraisal because

unanimous consent of the stockholders was necessary to warrant certain acts such as a consolidation or merger.

2. Corporations ⟹ 584

The granting of appraisal rights was given by the General Assembly, at least in part, in compensation for the lost right of the minority to defeat a merger.

3. Corporations ⟹ 584

The cashing out of a stockholder by the medium of a merger or a consolidation without adequate provision to determine if the cash-out price was fair would undoubtedly violate a stockholder's property rights.

4. Corporations ⟹ 584

Courts should liberally interpret the procedural requirements of the appraisal statute which enable a dissenting stockholder to obtain that to which he is entitled: the fair value of his shares. DEL. CODE ANN. tit. 8, § 262(b) (1974).

5. Corporations ⟹ 584

The purpose of requiring a corporation that is involved in a merger to inform its stockholders of the proper procedures which must be followed in an appraisal is to assist the stockholder to obtain an appraisal—not to deny him his rights.

6. Corporations ⟹ 584

When a corporation knows that many of its shares are held beneficially by a central security depository for stockholders on behalf of the stockholders' clients and the proxy materials detailing the requirements for exercise of appraisal rights do not state that reference to the central security depository or its nominee is mandatory, the corporation will be held to have had constructive notice that the beneficial owners' shares were listed on the corporation's records under the name of the nominee.

James F. Burnett, Esquire, of Potter, Anderson & Corroon, Wilmington, Delaware, for plaintiff-Margaret S. Earle.

Lawrence C. Ashby, Esquire, and Stephen E. Jenkins, Esquire, of Ashby, McKelvie & Geddes, Wilmington, Delaware, for plaintiff-Lucie Senouf

Samuel A. Nolen, Esquire, of Richards, Layton & Finger, Wilmington, Delaware, for defendant.

HARTNETT, *Vice-Chancellor*

Defendant ENSTAR Corporation objects to two separate demands for an appraisal of its shares made pursuant to 8 *Del. C.* §262. The demands were made by Margaret S. Earle and Lucie Senouf for an appraisal of the value of shares of stock owned beneficially by them at the time of the merger of Unimar Subsidiary, Inc. into ENSTAR on September 24, 1984. The objection is based on ENSTAR's claim that the pre-merger demands of Mrs. Earle and Mrs. Senouf for an appraisal as required by 8 *Del. C.* §262(d) were not submitted by the record owner of the shares—CEDE & CO. I find, after trial, that both Mrs. Earle and Mrs. Senouf are entitled to an appraisal of their shares.

I.

The essential facts are not disputed. Where facts are disputed, I find them to be as set forth. At the time of the merger Mrs. Earle was the beneficial owner of 10,441 shares of ENSTAR common stock. The shares were held for her in street name by Prudential-Bache Securities, Inc. At that time Prudential-Bache was listed on the books of ENSTAR as holding 1,043 shares of ENSTAR common stock in its own name. It had also caused CEDE & Co. to hold for it 379,268 shares of stock beneficially owned by customers of Prudential-Bache and to have the shares listed on the books of ENSTAR as being held by "CEDE & Co."

At the time of the merger Mrs. Senouf was the beneficial owner of 20,000 shares of ENSTAR stock which were held for her in street name by Drexel-Burnham Lambert. At that time all the shares of stock which Drexel-Burnham Lambert held for its customers were held and listed on the books of ENSTAR under the name "CEDE & Co."; 40,169 shares were so held.

II.

CEDE & Co. is a partnership used by The Depository Trust Company as its nominee to hold securities for its participants—all of which are brokerage firms, banks and other financial institutions. Neither The Depository Trust Company nor CEDE & Co. hold any shares for themselves but only hold shares as nominees for the participants in The Depository Trust Company. At the time of the merger CEDE & Co. was listed on the books of ENSTAR as holding over 7 million shares of its stock and there was no breakdown on the books of ENSTAR of the actual beneficial ownership of the CEDE holdings.

The use of CEDE & Co. and similar central security depositories to hold shares for stockbrokers, which shares are in turn held by the stockbrokers for their customers, has emerged as a major, if not dominant, method for the holding of shares of publicly traded corporations. The function performed by the central security depositories is to provide a central facility for the storage of enormous numbers of stock certificates and to provide a means for the transfer of shares without the actual transfer of certificates.

The emergence of central security depositories such as The Depository Trust Company and its nominee CEDE & Co., has led to the certificateless transfer of stock ownership—apparently without any statutory or case law permitting or regulating it. It has been suggested that without the type of service provided by the central security depositories it would be impossible to handle the large number of shares now traded daily in the various stock markets.

The wide use of central security depositories has resulted in a problem of the so-called "float." Because a large number of shares are bought and sold each day by brokers for various customers with only a notation that the shares have been bought or sold on the records of the central security depository, and because powers of attorney listing a central security depository as the nominee are executed and not immediately delivered, it is often impossible to ascertain with complete accuracy at any particular time just how many shares a central security depository holds in a particular company for a particular stock broker.

The publicly held corporations are well aware of the system and it is obviously to their advantage to have their shares held by central security depositories because this aids capital formation and it relieves the corporation of the paperwork which would he required if every owner of a share of stock had his shares listed in his own name on the books of the corporation.

III.

Individual stockholders, such as Mrs. Earle and Mrs. Senouf, who place their securities with a broker in a street name do not know that the broker then places the securities with a central security depository and that the securities are listed on the books of the corporation under the name "CEDE & Co." or similar names. Neither Mrs. Earle nor Mrs. Senouf had any actual knowledge that the securities which they had transferred to their broker to be held for them as beneficial owners, were listed on the books of ENSTAR under the CEDE & Co. name.

There is no question that ENSTAR knew that a large number of its shares were held in the name of CEDE & Co. and that CEDE & Co. was a nominee used by The Depository Trust Company which in turn held the shares for The Depository Trust Company's participants—stock brokerage firms, banks and other financial institutions which in turn held them for their customers, the actual beneficial owners.

ENSTAR received a monthly breakdown from The Depository Trust Company of all the shares held in CEDE & Co.'s name which showed the name of the stock broker, etc., for whom the shares were being held and which purportedly listed the number of shares held for each broker. ENSTAR was also entitled to receive, on request, supplementary lists. As noted previously, however, the breakdowns were not completely accurate because of the existence of the float.

ENSTAR knew from the data submitted to it by The Depository Trust Company that at the time of the merger that CEDE & Co. held over 7 million shares of ENSTAR and that the shares were held for brokerage firms, banks or other financial institutions which in turn held them for customers. It was also aware that CEDE & Co. held 379,268 shares for customers of Prudential-Bache and 40,169 shares for customers of Drexel-Burnham Lambert.

On September 24, 1984 Prudential-Bache, at the request of Mrs. Earle, made a pre-merger demand in writing on ENSTAR for the appraisal of 10,441 shares, stating that the demand was on behalf of its client Margaret S. Earle. Mrs. Earle also voted her shares against the merger.

The objection of ENSTAR as to the Earle claim arises because Prudential-Bache in its pre-merger demand letter stated that demand for an appraisal was made by Prudential-Bache on behalf of its client Margaret Earle and did not mention that her shares were listed on the books of ENSTAR under the name "CEDE & Co."

The objection of ENSTAR as to the Senouf claim arises because on September 15, 1984, a Mr. Champy, on behalf of Mrs. Senouf, sent a letter to ENSTAR stating:

> "As agent for Mrs. Lucie Senouf, with full power of attorney, I inform you that I elect to exercise for her the rights of appraisal under Section 262 of the Delaware corporation law.
>
> Mrs. Lucie Senouf owns 20,000 shares of Enstar Corp. common. All these shares will be subject to appraisal rights. They are deposited at Drexel Burnham Lambert, [account number]. Her address in France is also 21 rue du Midi, Neuilly.
>
> She did not sell any share to Unimar through their $20 offer in June, and she does not intend to vote for the merger."

A copy of Mr. Champy's power of attorney was enclosed. On October 5, 1984, ENSTAR advised Mrs. Senouf that the merger had taken place and that her demand for an apprsisal had been received.

No pre-merger demand for an appraisal for Mrs. Earle's or Mrs. Senouf's shares was made by CEDE & Co.

The former secretary of ENSTAR testified that if the pre-merger demand letters had stated that the demands were being made by the brokers and CEDE & Co. for Mrs. Earle and Mrs. Senouf, there would have been no objection to an appraisal for these shares and the corporation did not object to other demands for an appraisal from brokers for customers if they included a reference to CEDE & Co.

IV.

Initially certain dissenting stockholders attempted to enjoin the acts which eventually led to the merger which has lead to this appraisal action. In *Thompson v. Enstar Corporation*, Del. Ch., C.A. #7641-NC and C.A. #7643-NC, Hartnett, V.C. (June 20, 1984), the dissenters alleged that the corporation's assets were going to be sold for a grossly inadequate consideration. Because of the peculiar factual background, this Court refused to grant the extraordinary remedy of a preliminary injunction to block the sale. The merger of Unimar Subsidiary into ENSTAR therefore eventually occurred on September 24, 1984. Many dissenting stockholders objected to the merger and

demanded an appraisal. See *Huffington v. Enstar*, Del. Ch., C.A. Nos.7802-NC, 7857-NC and 7864-NC, Hartnett, V.C. (March 8, 1985) and *In the Matter of the Appraisal of ENSTAR CORPORATION*, Del. Ch., C.A. #7802-NC, Hartnett, V.C. (April 29, 1986). On March 14, 1986, I approved a settlement of the appraisal action which provided that the dissenting stockholders who were entitled to an appraisal would receive a consideration approximately double the merger consideration. If Mrs. Earle's and Mrs. Senouf's shares are entitled to an appraisal, they will receive the settlement consideration; if not, they will be relegated to the merger price.

V.

The ENSTAR Proxy Statement sent in connection with the merger set forth the procedural requirements for a dissenting stockholder to obtain an appraisal of his shares. This stated in part:

> "A stockholder of record of ENSTAR electing to exercise appraisal rights under Section 262 must deliver a written demand for appraisal of his Common Shares or Preferred Shares (as the case may be) to ENSTAR prior to the vote on the approval and adoption of the Merger Agreement and the Agreement of Merger, and must not vote for the approval and adoption of the Merger Agreement and the Agreement of Merger. Such written demand is in addition to and separate from any proxy or vote against the Merger and must reasonably inform ENSTAR of the identity of the stockholder of record and of such stockholder's intention to demand appraisal of his Common Shares or Preferred Shares (as the case may be). Because a proxy signed and left blank will, unless revoked, be voted FOR approval and adoption of the Merger Agreement and the Agreement of Merger, in order to be assured that his Common Shares or Preferred Shares (as the case may be) are not voted for approval and adoption of the Merger Agreement and the Agreement of Merger, the stockholder electing to exercise appraisal rights who votes by proxy must not leave his proxy blank, but must either vote AGAINST the approval and adoption of the Merger Agreement and the Agreement of Merger or ABSTAIN from voting.
>
> Only the holder of record of Common Shares or Preferred Shares (as the case may be) is entitled to seek ap-

praisal of the fair value of the Common Shares or Preferred Shares (as the case may be) registered in such holder's name. The demand for appraisal must be executed by or for the holder of record, fully and correctly, as such holder's name appears on the holder's stock certificates. If the stock is owned of record in a fiduciary capacity, such as by a trustee, guardian or custodian, the demand should be made in that capacity, and if the stock is owned of record by more than one person, as in a joint tenancy or tenancy in common, the demand should be made by or for all owners of record. An authorized agent, including one or more joint owners, may execute the demand for appraisal for a holder of record; however, such agent must identify the record owner or owners and expressly disclose in such demand that the agent is acting as agent for the record owner or owners.

A record holder such as a broker who holds Common Shares or Preferred Shares as nominee for beneficial owners, some of whom desire to demand appraisal, must exercise appraisal rights on behalf of such beneficial owners with respect to the stock held for such beneficial owners. In such case, the written demand for appraisal should set forth the number of Common Shares or Preferred Shares covered by it. Unless a demand for appraisal specifies a number of Common Shares or Preferred Shares, such demand will be presumed to cover all Common Shares or Preferred Shares (as the case may be) held in the name of such record owner.

There is no allegation that Mrs. Earle or Mrs. Senouf did not fully comply with the procedural requirements other than as to their pre-merger notices to ENSTAR, made pursuant to 8 *Del. C.* §262(d)(1); nor has ENSTAR alleged that it suffered any prejudice because of the form of the pre-merger demands.
[Start - Revised July 23, 1986]

VI.

The pertinent statutory provision provides:

"(d) Appraisal rights shall be perfected as follows:

(1) If a proposed merger or consolidation for which appraisal rights are provided under this section is to be submitted for approval at a meeting of stockholders, the

corporation, not less than 20 days prior to the meeting, shall notify each of its stockholders entitled to such appraisal rights that appraisal rights are available for any or all of the shares of the constituent corporations, and shall include in such notice a copy of this section. *Each stockholder electing to demand the appraisal of his shares shall deliver to the corporation, before the taking of the vote on the merger or consolidation, a written demand for appraisal of his shares. Such demand will be sufficient if it reasonably informs the corporation of the identity of the stockholder and that the stockholder intends thereby to demand the appraisal of his shares.* A proxy or vote against the merger or consolidation shall not constitute such a demand. A stockholder electing to take such action must do so by a separate written demand as herein provided. Within 10 days after the effective date of such merger or consolidation, the surviving or resulting corporation shall notify each stockholder of each constituent corporation who has complied with this subsection and has not voted in favor of or consented to the merger or consolidation of the date that the merger or consolidation has become effective;" (emphasis added) 8 *Del. C.* §262.

VII.

[1] At common law there was no provision for an appraisal because unanimous consent of the stockholders was necessary to warrant certain acts such as a consolidation or merger. *Voeller v. Neilston Warehouse Co.*, 311 U.S. 531; 85 L.Ed. 322, 61 S.Ct. 376; *Chicago Corp. v. Munds*, Del. Ch., 172 A. 452 (1934). Ever since 1899 Delaware law has permitted a stockholder's interest to be terminated by the payment of its value in the case of a consolidation, however. 21 *Del. L.*, Ch. 273 §56. Initially a super majority vote of all the stockholders was required, but now only a simple majority need approve a merger or consolidation.

[2-4] The granting of appraisal rights to a dissenting stockholder is therefore more than mere largesse of the General Assembly. It was given, at least in part, in compensation for the lost right of the minority to defeat a merger. *Chicago Corp. v. Munds*, supra; BALLANTINE AND STERLING, *California Corporation Laws*. The cashing out of a stockholder by the medium of a merger or consolidation without adequate provision to determine if the cash-out price was fair would undoubtedly also violate a stockholder's property rights.

Cf. *Keller v. Wilson & Co., Inc.*, Del. Supr., 190 A. 115 (1936); *Federal United Corp. v. Havender*, Del. Supr., 11 A.2d 331 (1940). Courts should, therefore, liberally interpret the procedural requirements which enable a dissenting stockholder to obtain that to which he is entitled: the fair value of his shares.

VIII.

The Delaware Supreme Court in *Raab v. Villager Industries, Inc.*, Del. Supr., 355 A.2d 888 (1976) recognized that the procedural mandate of the appraisal statute must be liberally construed.
[End - Revised July 23, 1986]

As stated in *Raab*:

> "The requirements of §262(b) are to be liberally construed for the protection of objecting stockholders, within the boundaries of orderly corporate procedures and the purpose of the requirement. (cites omitted)"

The *Raab* Court also noted:

> ". . . The only purpose of requiring an objection in writing prior to the stockholders' meeting is to give some advance notice [to corporate officers and other stockholders] of possible dissentients. The purpose is not to make known to a certainty those who will dissent, for as has been pointed out, a stockholder who objects in writing is still at liberty to vote his shares in favor of the merger, or even to vote his shares against the merger and then conclude to accept its benefits. * * * The purpose of the statute in requiring an objection in writing is merely to give notice." citing *Zeeb v. Atlas Powder Co.*, Del. Supr., 87 A.2d 123, 127 (1952).

IX.

In *Raab* the Delaware Supreme Court laid down the disclosures required to be made to a stockholder who is about to be cashed-out. The Court said:

> "A Delaware corporation, engaged in §262 proceedings, henceforth shall have an obligation to issue specific instructions to its stockholders as to the correct manner of executing and filing a valid objection or demand for payment under the Statute, as construed by Delaware courts,

> including: (1) the general rule that all such papers should be executed by or for the stockholder of record, fully and correctly, as named in the notice to the stockholder; and (2) the manner in which one may purport to act for a stockholder of record, such as a joint owner, a partnership, a corporation, a trustee, or a guardian.
>
> Fairness to stockholders require such reasonably specific instructions in §262 proceedings. As a general rule in the future, failure by the corporation to furnish such instructions will result in the resolution in favor of the stockholder of all doubt as to the sufficiency, for corporate purposes, of the objection or demand."

ENSTAR, in its proxy materials, stated that only the holder of record is entitled to seek an appraisal and that the appraisal demand should be executed by the holder, but the proxy also stated: "If the stock is owned of record in a fiduciary capacity, such as trustee, guardian, or custodian, the demand *should* be made in that capacity . . ." (emphasis added)

The proxy materials, in addition, stated:

> "A record holder such as a broker who holds Common Shares or Preferred Shares as nominee for beneficial owners, some of whom desire to demand appraisal, must exercise appraisal rights on behalf of such beneficial owners with respect to the stock held for such beneficial owners. In such case, the written demand for appraisal should set forth the number of Common Shares or Preferred Shares covered by it. . . ."

Significantly, the detailed instructions made no mention of how the exercise of appraisal rights was to be accomplished where shares were held in the name of a nominee of a central security depository such as CEDE & Co. although ENSTAR knew that over 7 million of its shares were so held and that the proxy materials would be distributed through CEDE & Co. and its broker participants to the beneficial owners of the stock. The proxy materials also did not state that a reference to the name of a central depository or its nominee was mandatory if the shares were so listed on the books of ENSTAR.

Mrs. Earle and Mrs. Senouf, therefore, were given no notice that if they wished to seek an appraisal they were required to notify ENSTAR that their shares were listed on the books of ENSTAR in the name of CEDE & Co.—a name that they did not even know existed.

[5] The purpose of requiring a corporation that is involved in a merger to inform its stockholders of the proper procedures which must be followed to obtain an appraisal is to assist the stockholder obtain an appraisal—not to deny him his rights.

[6] When the totality of the circumstances present here are considered, it is clear that ENSTAR had reasonable constructive notice that Mrs. Earle's and Mrs. Senouf's shares were listed on the corporation records under the name "CEDE & Co." and that its refusal to permit Mrs. Earle and Mrs. Senouf to receive the settlement consideration is based on impermissible hypertechnicalities. Mrs. Earle and Mrs. Senouf are therefore entitled to an appraisal and thus entitled to receive the settlement consideration.

IT IS SO ORDERED.

FABINIAK v. DWYER

No. 8500

Court of Chancery of the State of Delaware, New Castle

June 12, 1986

Petitioners and respondents were competing groups seeking to gain control of Hybrilonics, Inc. Respondents had seized control of Hybrilonics through written shareholder consents allegedly executed pursuant to DEL. CODE ANN. tit. 8, § 228 (1971) by a majority of the corporation's shareholders. Petitioners sought a temporary restraining order to set aside their removal as the corporation's directors, asserting that their removal was unlawful because the shareholders' written consents allegedly executed pursuant to DEL. CODE ANN. tit. 8, § 228 (1971) were defective, and therefore improperly voted.

The court of chancery, per Vice-Chancellor Hartnett, denied petitioners' application for a temporary restraining order holding that: (1) the record was insufficient and the facts unclear as to whether the holders of a majority of the corporation's shares actually consented to the directors' removal by properly executed written consents, and (2) it was impossible to resolve the disputed facts surrounding written consent procedure within the framework of an application for a temporary restraining order.

1. Corporations ⟹ 294

Shareholders' removal of corporation's directors by written consent procedure pursuant to DEL. CODE ANN. tit. 8, § 228 (1971) has great potential for mischief, and therefore, the provisions of that section must be strictly complied with to avoid corporate anarchy. DEL. CODE ANN. tit. 8, § 228 (1971).

2. Corporations ⟹ 294

Injunction ⟹ 137(1)

An application for temporary restraining order to set aside removal of directors by shareholders' written consents executed pursuant to DEL. CODE ANN. tit. 8, § 228 (1971) will be denied when disputed questions of fact exist with respect to the validity of written consents, which cannot be resolved within the framework of application for a temporary restraining order.

Craig B. Smith, Esquire, of Lassen, Smith, Katzenstein & Furlow, Wilmington, Delaware, for petitioners.

Januar D. Bove, Jr., Esquire, of Connolly, Bove, Lodge & Hutz, Wilmington, Delaware, for respondents.

HARTNETT, *Vice-Chancellor*

Petitioners seek a temporary restraining order to set aside a purported removal of the directors of Hybrilonics, Inc., a Delaware corporation. The directors were allegedly removed by means of written consents executed pursuant to 8 *Del.C.* §228. It is impossible from the present record to ascertain the true facts as to whether the holders of a majority of the stock consented to the removal, and therefore the application for a temporary restraining order must be denied.

I.

Named as respondents in this suit are Herbert E. Dwyer, F. Emerson Ivey, Jerry Ashenberg and Hybrilonics, Inc. None of the respondents appeared, but Richard Freeman, Gregory H. Hill, William Lerner, and Atlantic Financial Concepts, Inc. appeared through

counsel and requested leave to intervene in this suit. Messrs. Freeman, Hill and Lerner are the plaintiffs in a related action in ths Court (*Freeman v. Fabiniak*, C.A. #8035-NC). Atlantic Financial Concepts, Inc. is a major creditor of Hybrilonics, Inc. and apparently has had a major role in orchestrating the purported takeover. At the commencement of the proceedings I granted the Motion To Intervene and the Intervenors took a position defending the actions of the named respondents.

II.

This controversy has previously been before me In C.A. No. 8035-NC and on August 15, 1985, after trial, I ruled that various earlier attempts to take over the governance of Hybrilonics, Inc. were ineffective. I directed that a properly supervised annual stockholders meeting take place to determine the directors of the corporation.

The annual meeting was held, pursuant to Court Order, on October 31, 1985, under supervision of Prentice-Hall Corporation System, Inc. which certified that Herbert Dwyer, Thaddeus J. Fabiniak, Richard C. Fabiniak, Terry Fees, and F. Emerson Ivey were duly elected as directors. Mr. Ivey subsequently resigned.

In my August 15, 1985, opinion I termed the earlier attempts to take over Hybrilonics a "corporate fiasco" and I strongly criticized some of the actions of both competing groups.

The two competing groups are now back again and, as might be expected, the activities of both seem to fall short of the fiduciary duty each owes to the hapless minority stockholders of this corporation.

On April 15, 1986, in C.A. No. 8035-NC the plaintiffs in that case filed a motion to set aside the October 31, 1985, election. Counsel for defendants in that case subsequently requested a delay until May 31, 1986, to submit their answering brief. This request was granted by the Court over the objection of plaintiffs' new counsel—Mr. Bove—who is also the counsel for the Intervenors in the present action (C.A. No. 8500-NC).

From the papers filed in C.A. No. 8035-NC on April 15, 1986, it is obvious that Herbert E. Dwyer, an original defendant in C.A. No. 8035-NC, has now become aligned with the plaintiffs in that case.

Apparently frustrated by the Court's decision on the briefing schedule in C.A. No. 8035-NC, Messrs. Dwyer, Ivey and Ashenberg, the respondents in the present action (C.A. No. 8500- NC) on May

19, 1986, by surprise and the use of force, seized control of the facilities of Hybrilonics, Inc. and installed themselves as the directors of the corporation. Their seizure of the corporate machinery and assets was done by the use of written consents purportedly executed pursuant to 8 *Del.C.* §228 by the holders of a majority of the shares of stock of the corporation.

The Petitioners in the case now before me (C.A. No. 8500-NC) are Thaddeus J. Fabiniak and Richard C. Fabiniak who are two of the five directors elected on October 31, 1985. Richard was also Vice President of the corporation until May 19, 1986. They now seek to restore the *status quo* by being reinstalled as directors of Hybrilonics pending a further decision as to control of the corporation.

III.

[1] In both my August 15, 1985 Opinion in *Freeman v. Fabiniak*, C. A. No. 8035-NC and in *Empire of Carolina v. Deltona Corp.*, Del.Ch., 501 A.2d 1252, *aff'd.* by Order, Del.Supr., 505 A.2d 452, I pointed out that the taking of action by written consent instead of at a stockholders' meeting has great potential for mischief. The provisions of 8 *Del.C.* §228 must, therefore, be strictly complied with if corporate anarchy is to be avoided. *Empire of Carolina v. Deltona Corp., supra.* The actions taken by the respondents here confirm the wisdom of that rule.

The insurgents without prior notice to the presumably duly elected directors took possession of the corporate office and facilities early on Monday morning, May 19, 1986, and by the use of force prohibited the petitioners (one of whom is a corporate officer and both of whom are directors) from entry. Violence occurred as a result of the activities.

The insurgents showed the dispossessed documents purporting to justify their action but the documents were defective in that they did not include copies of the written consents. The petitioners also established that a large number of shares of stock allegedly voted by written consent for the respondent-directors by proxy were not accompanied by the proxies, and they established that it is reasonably probable that there are other shares of stock of Hybrilonics, Inc. which were improperly voted.

[2] Defective consents cannot be counted in ascertaining whether insurgents have a majority vote at the time of a takeover and under different circumstances this alone would be sufficient to set aside the

seizure, but it is unclear from the present record whether the defective written consents are sufficient to affect the result.

A proceeding on an application for a temporary restraining order is especially unsuited for the consideration of competing factual allegations. There exist, in the present case, disputed questions of fact as to a large number of the written consents, which cannot be resolved within the framework of an application for a temporary restraining order.

The conduct of Messrs. Fabiniak (the petitioners here and defendants in C.A. No. 8035-NC) also leaves a great deal to be desired. Despite my ruling in C.A. No. 8035-NC they have not transferred to Atlantic Financial the over 28 million shares to which I found Atlantic Financial was entitled. Their response to this is that Atlantic Financial has never requested the transfer despite the fact that the motion filed on April 15, 1986, in C.A. No. 8035-NC seeks the transfer.

It also appears likely that the Fabiniaks have caused to be issued 5 million additional shares of stock to themselves or their family without consideration.

In short, I am faced with an imperfect record on an application for a temporary restraining order where the respondents have not even been served and did not appear and almost all the factual allegations are disputed.

I am also faced with the fact that the respondents have been running the corporation since May 16, 1986, and have arranged for additional capital to be raised to make certain payments to creditors which were past due.

Obviously the final chapter in this controversy, which may well cause the demise of Hybrilonics, is yet to occur, but the true *status quo* is that the new board is in charge.

Because the time for another annual meeting is fast approaching, and because there are so many unresolved issues the best way to resolve this controversy, it seems to me, is for there to be a new annual election under the supervision of a Master who can resolve the many disputes which are likely to arise.

This action (C.A. No. 8500-NC) should also be consolidated with C.A. No. 8035-NC under a new caption. The Intervenors shall submit an appropriate order of consolidation.

The application for a temporary restraining order is therefore denied. IT IS SO ORDERED.

GARRETT v. BROWN

Nos. 8423 & 8247

Court of Chancery of the State of Delaware, New Castle

June 13, 1986

Plaintiffs, shareholders in Stater Brothers, a supermarket chain, challenged the election of defendants' rival slate of directors over that of plaintiffs' slate. Plaintiffs claimed that election results should be reversed due to defendants' voting of 400,000 shares to which plaintiffs claimed equitable ownership pursuant to a provision of the Stockholders Agreement. The Stockholders Agreement prohibited transfers of stock by one shareholder before other shareholders were given right of first refusal. Defendants maintained that the shares were not subject to the restriction since they were not transferred but instead used as a pledge. The court of chancery, per Vice-Chancellor Berger, held that the Craig Agreement was a pledge, should not be construed as involving the transfer of restricted shares, and that such agreement does not limit the shareholders' freedom to vote their shares as they see fit. Thus the results of the election should be certified.

1. Contracts ⟹ 144

Shareholders' agreement which provides that it is to be construed in accordance with California law is valid since contracting parties have the right of choice of selection of jurisdiction under whose law their contract will be governed, and California law comports favorably with that of the state of Delaware, the forum state.

2. Contracts ⟹ 147(1)

Contracts are to be construed as a whole in a manner that will give effect to the intent of the parties.

3. Contracts ⟹ 152

Contractual language should be construed in accordance with its plain and ordinary meaning unless it is given some special or technical meaning.

4. Contracts ⟹ 170(1)

The meaning of ambiguous language may be ascertained by the manner in which the parties operated under the contract.

5. Contracts ⟹ 154

When more than one interpretation is possible, the court should adopt that which will produce a reasonable and equitable result.

6. Contracts ⟹ 318

When a stockholders' agreement provides that the purchase price for shares under a right of first refusal where shares are pledged would be the value of the loan rather than the market value, such provision would operate as a partial forfeiture and should not be held to be valid since forfeitures are not favored and contracts will be construed to avoid such a result.

7. Contracts ⟹ 143

In construing a section of a shareholders' agreement providing for the right of first refusal by other shareholders when shareholder wishes to transfer stock, the principle that all provisions in a contract should be given effect in accordance with the parties' intent must be balanced against the premise that the court will not rewrite a contract to add provisions not included by the parties.

8. Contracts ⟹ 156

In case of conflict among contract provisions, specific provisions are construed as a limitation on more general provisions.

9. Contracts ⟹ 170(1)

Where an agreement by its terms contemplates further refinement by the parties depending on future events, it is not fully integrated so that the parties' rights and obligations may be liberally construed.

A. Gilchrist Sparks, III, Esquire, and Michael Houghton, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware; and

Richard Osborne, Esquire, and Robert Kendrick Wrede, Esquire, of Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey, Beverly Hills, California, for Messrs. Garrett, Grant, McKenzie, Nash, Partridge, Resnik, Zweig, Burkle, and Stater Bros., Inc.

R. Franklin Balotti, Esquire, and Kevin G. Abrams, Esquire, of Richards, Layton & Finger, Wilmington, Delaware; and Latham & Watkins, Los Angeles, California, for Lisa Garrett and Mitchel Garrett, individually and as Trustees of the Voting Trust and Irving Garrett, as Trustee of the Voting Trust.

Bruce M. Stargatt, Esquire, Edward B. Maxwell, 2nd, Esquire, David C. McBride, Esquire, Josy W. Ingersoll, Esquire, and William D. Johnston, Esquire, of Young, Conaway, Stargatt & Taylor, Wilmington, Delaware; and Douglas C. Conroy, Esquire, Todd E. Gordinier, Esquire, and Amy B. Jenkins, Esquire, of Paul, Hastings, Janofsky & Walker, Los Angeles, California, for Messrs. Brown, Varner, Wallace, Carr, Matich, and La Cadena Investments.

BERGER, *Vice-Chancellor*

This is the decision on the second phase of these consolidated actions brought pursuant to 8 *Del. C.* §225 to determine the directors of Stater Bros., Inc. ("Stater Bros."). In its decision of April 22, 1986, this Court held that a stockholders' meeting conducted on March 20, 1986 was not properly noticed and, as a result, the three directors nominated by Jack H. Brown were not elected. Stater Bros. was ordered to hold its annual meeting on April 28, 1986—the postponed date selected by the company's incumbent board. Two days later, plaintiffs in Civil Action No. 8423—Messrs. Bernard R. Garrett, Paul R. Grant, Leonard Douglas McKenzie, Daniel Nash, John W. Partridge, Mark A. Resnik and Bertram R. Zweig (collectively the "Garrett Group") and Stater Bros., filed their Fourth Amended and Supplemental Complaint challenging the election results.

Prior to trial, which was held on May 22 and 23, 1986, the parties stipulated to the joinder of Lisa and Mitchel Garrett, individually and as trustees of a certain voting trust, and Irving Garrett, as trustee of the certain voting trust, as plaintiffs. La Cadena Investments, a California general partnership ("La Cadena") joined

Messrs. Jack H. Brown ("Brown"), Bruce D. Varner, John C. Wallace, Laurence J. Carr and Martin A. Matich (collectively the "Brown Group") as party defendants.

The history of the parties' acquisition of Stater Bros. and their relatively short-lived coalition in the management of the company was described in the earlier decision and will not be repeated here except to the extent necessary to an understanding of the present controversy. *See, Garrett, et al. v. Brown, et al.*, Del. Ch., Civil Action Nos. 8423, 8427 Consolidated, Berger, V. C. (April 22, 1986). Prior to the acquisition in March, 1983, Stater Bros. Markets ("Markets"), a wholly-owned subsidiary of Petrolane, Inc., owned and operated a chain of 94 supermarkets located in Southern California. The principal executives of Markets at the time were Messrs. Brown, Davis, Lightfoot, Woodstra and Moseley—now general partners in La Cadena (collectively the "La Cadena Group"). Following the acquisition, which was accomplished through a leveraged buy-out, Lisa Garrett, acting on behalf of the Garrett family (the "Garretts") owned 51% of Stater Bros. (the holding company for Markets) and La Cadena owned 49% of the stock.

In an effort to "preserve the continuity of harmonious management" of the company and its subsidiaries, the Garretts and the La Cadena Group entered into a stockholders' agreement effective March 22, 1983 (the "1983 Agreement") governing, among other things, the transferability of the Stater Bros. stock. The 1983 Agreement prohibited the sale, transfer, assignment, hypothecation or other alienation of any Stater Bros. stock without the prior written consent of the other stockholder. Absent such consent, the non-transferring stockholder was given a right of first refusal to meet the terms of the proposed transfer and be substituted for the proposed transferee. In other specified circumstances, such as the filing of a bankruptcy petition by or against one of the stockholders, the other stockholder was given an option to purchase the affected shares. In two subsequent versions of the 1983 Agreement, the transfer restrictions, rights of first refusal and options to purchase were continued in substantially the same form.

The current agreement, dated September 18, 1985 (the "Stockholders' Agreement"), contains somewhat different transfer provisions in light of the fact that the company was about to make a public offering of its stock. By contrast to its three predecessors, it contains no statement of a purpose to preserve the continuity of harmonious management by reserving the stock of the corporation

to the parties. This omission is readily understandable since, as a result of the offering, approximately 25% of the company's stock was publicly held and the Garrett and La Cadena holdings were reduced to approximately 38% and 37% respectively. As will be discussed hereafter, the result of the contested election turns upon the meaning and application of Section 4 of the Stockholders' Agreement, which provides in relevant part:

> *Section 4. Right of First Refusal Upon Transfer.*
>
> 4.1 *Prohibition on Transfers.* Except with the written consent of the other Shareholders or as provided in this Section 4, none of the Shareholders or their legal representatives shall Transfer any shares of the Common Stock or any right, title and interest therein or thereto. Any shares of the Common Stock Transferred by a Shareholder or his transferee to another Person, except those Transferred free of the restrictions of this Agreement pursuant to Section 4.9, shall, after such Transfer, continue to be subject to all the terms hereof as if still owned by such Shareholder.
>
> * * *
>
> 4.3 *Delivery of Sell Notice.* Except for Transfers permitted pursuant to Section 4.2 [dealing with transfers between members of the Garrett Group and La Cadena Group respectively], in the event that a Shareholder (the "Seller") shall desire to Transfer all or a part of the shares of the Common Stock held by such Shareholder, he shall deliver to each of the other Shareholders in the Group of which he is a member and to the other Group (such non-selling Shareholders and Group are referred to in this Section 4 as the "Non-Selling Persons") a written notice (the "Sell Notice") stating (i) the identity of the prospective purchaser, (ii) the "Stock Purchase Price" (as that term is defined in Section 4.5 hereof), (iii) the calculations. data and other information by which such Stock Purchase Price was determined by the Seller, (iv) the terms and conditions upon which such Transfer is proposed to be made to such prospective purchaser. . .and (v) in the event any Non-Cash Consideration is proposed to be paid in connection with such Transfer, the written opinion of the Investment Banker as to the amount of the Stock Purchase Price represented by such Non-Cash Consideration.

4.4 *Option to Purchase Offered Stock.*

4.4.1 Upon delivery of the Sell Notice, each of the Non-Selling Persons shall have the non-transferable and irrevocable option (the "Purchase Option"), exercisable as hereinafter provided, to purchase all of the Common Stock with respect to which the Sell Notice has been given (the "Offered Shares"). The Purchase Option may be exercised at any time within the 15-day period. . . .commencing on receipt. . .of the Sell Notice by (i) delivery of a written notice. . .to the Seller (x) stating that the exercising party (the "Buyer") intends to exercise the purchase Option and (y) specifying a date on which the Stock Purchase Price will be paid. . .and (ii) if the Stock Purchase Price. . .is greater than $100,000, payment in cash or immediately available funds to the Seller of an option exercise fee equal to the lesser of (a) $1,000,000 or (b) ten percent (10%) of the Purchase Price set forth in the Sell Notice. . . .

4.4.2 As between the Non-Selling persons, those Shareholders who are members of the same Group as the Seller shall have the initial right to purchase the Offered Shares. If those Non-Selling Persons having the initial right to Purchase the Offered Shares fail to exercise such right in the manner set forth in Section 4.4.1 within ten days after receipt by the last of the Non-Selling Persons of the Sell Notice, the remaining Non-Selling persons shall have the right to purchase the Offered Shares for the remainder of the Purchase Option.

While the first phase of this action was being litigated, the parties were engaged in a proxy contest in anticipation that the Court would rule, as it did, that the March 20, 1986 election was of no effect. Both the Garretts and La Cadena obtained several million dollars in financing to assist in the acquisition of the publicly held stock. By early April, it would appear that the La Cadena Group needed additional capital to continue in its effort to acquire control of Stater Bros. Craig Corporation ("Craig") was approached by La Cadena's investment banker, and following negotiations, a letter agreement dated April 11, 1986 (the "Craig Agreement") was executed.

Pursuant to the Craig Agreement, Craig committed to using its best efforts to purchase enough Stater Bros. stock to constitute a

majority when combined with La Cadena's holdings and to vote those shares for the La Cadena slate of directors. In return, La Cadena agreed to effectuate one of three possible transactions, at Craig's election: (i) after October 15, 1986, to reduce Craig's average cost for the Stater Bros. stock to $15 per share either by transferring additional Stater Bros. stock to Craig at no cost or at an amount less than $15 per share or by paying cash [Election (i)]; (ii) after October 15, 1986, to purchase Craig's holdings at an amount equal to Craig's cost plus an annual compounded return of 8%; or (iii) after April 15, 1986, to purchase as much Stater Bros. stock as Craig may designate at a price equal to Craig's cost, but not to exceed $6 million, by giving Craig a convertible purchase money promissory note to be secured, to the extent possible, by a pledge of that number of Stater Bros. shares equal to the conversion feature of the note [Election (iii)]. After describing these options, the Craig Agreement states:

> Craig acknowledges that La Cadena's assets consist almost exclusively of its holdings of Stater Bros. Stock, that a portion of these holdings is subject either to certain rights of first refusal held by certain members of the Garrett Group pursuant to. . .[the Stockholders' Agreement] or to certain bank liens, and that as a result a reasonable period of time and a reasonable amount of cooperation on the part of Craig may be required in order to carry out the intent and objectives of certain of the options described above. (Craig Agreement, p. 2-3).

The Craig Agreement goes on to state, generally, the parties' intentions in the event that they are able to obtain control of Stater Bros., including their plan to equalize their holdings. In addition, regardless of whether the parties acquire control, the Craig Agreement provides for a right of first refusal in connection with the transfer of any of the parties' stock.

The Garretts determined that the Craig Agreement constituted a transfer of various rights in and to the stock subject to the Stockholders' Agreement and, by letter dated April 14, 1986, attempted to exercise their purchase option as to 400,000 shares at the price of $15 per share pursuant to Election (iii) of the Craig Agreement. The exercise letter explained that the Garretts intended to purchase all of the stock to which they were entitled within the option period but that they would close on the 400,000 shares on the following

day. The Garretts advised La Cadena that, as of the closing, they would become the equitable owners of the stock at issue and instructed La Cadena to take all steps necessary to vote those shares for the Garrett slate of nominees. The letter was accompanied by an irrevocable standby letter of credit in the amount of $1 million—the option exercise fee.

La Cadena did not appear at the closing on April 15th and, with a letter dated April 17, 1986, the Garretts tendered the remainder of the purchase price through another irrevocable standby letter of credit. The Garretts again instructed La Cadena to vote the 400,000 shares for its slate.

La Cadena responded by letters dated April 17 and 18, 1986 to the effect that the Craig Agreement did not result in the present transfer of any stock subject to the Stockholders' Agreement. It acknowledged that some of the possible transactions described in the Craig Agreement could involve the transfer of Stater Bros. stock to Craig and that if, in the future, a decision were made to transfer restricted shares, La Cadena would comply with its obligations under the Stockholders' Agreement. Further, La Cadena's letters advised that neither it nor Craig intended to effect any transaction prohibited by Section 4.1 of the Stockholders' Agreement and that the parties to the Craig Agreement would interpret their agreement to avoid any such conflict.

Apparently as a precaution, four of the La Cadena partners gave written notice on April 21, 1986 of their desire to exercise their prior right to purchase in the event that it is determined that the purchase option provisions of the Stockholders' Agreement were triggered by the Craig Agreement. The La Cadena partners did not tender the exercise option fee or specify a closing date for the purchase of the subject shares.

At the April 28th meeting there were 4,027,338 shares represented. La Cadena held of record 1,742,646 shares, of which 1,543,500 were subject to the Stockholders' Agreement. The La Cadena partners held a total of 75,000 shares, none of which were subject to the Stockholders' Agreement, and Craig Corporation held 285,950 shares. A total of 2,208,321 shares were voted in favor of the La Cadena slate of directors including the 400,000 shares as to which the Garretts claim to be equitable owners. Two of the Garrett nominees—Messrs. Zweig and Partridge— received 1,810,470 votes and the third Garrett nominee—Mr. Burkle—received 1,810,670 votes. As can be seen from these tallies, the 400,000 shares at issue would, if removed

from the La Cadena slate's total and added to the Garrett slate, result in the election of the Garrett slate of nominees.

The Garrett Group argues that the Craig Agreement violated both the express terms of the transfer provisions in the Stockholders' Agreement as well as the parties' purpose in including those transfer restrictions in their agreement. The Brown Group disputes this contention and also argues that it should prevail for any of four alternative reasons: (1) the Garretts cannot enforce the transfer provisions because of their own prior material breach of those provisions; (2) the La Cadena partners have exercised their prior purchase option; (3) the number of shares subject to the purchase option purportedly exercised by the Garretts is not 400,000 but only approximately 125,000 and, thus, would not be enough to alter the election results; and (4) for various reasons, including their failure to exercise the purchase option as to all the affected shares, the Garretts' attempt to purchase La Cadena's restricted stock was ineffective.

[1] The parties apparently agree that the Stockholders' Agreement is to be construed in accordance with California law inasmuch as the agreement so provides. It was negotiated and executed in California by residents of that state and the company's principal place of business and operating facilities are located there. *Wilmington Trust Company v. Wilmington Trust Company*, Del. Supr., 24 A.2d 309 (1942). California law as to the interpretation of contracts appears to be consistent with generally applied legal principles and the applicable law of this jurisdiction.

[2-5] For example, contracts are to be construed as a whole in a manner that will give effect to the intent of the parties. *People v. Marsicano*, Cal. Dis. Ct. App., 135 P.2d 16 (1943); *DuPont v. Wilmington Trust Co.*, Del. Ch., 45 A.2d 510, 517 (1946). The parties' intent should be determined, in the first instance, from the language used in the contract, *Williston on Contracts* 3d Ed., 601 (1961), but may also be determined by reference to the circumstances under which the contract was executed. *Motif Records Corp. v. Brummer*, Cal. Ct. App., 9 Cal. Rptr. 356 (1960); *Tull v. Turek*, Del. Supr., 147 A.2d 658 (1958); *Gluckman v. Holzman*, Del. Ch., 51 A.2d 487 (1947). As a general rule, contractual language should be construed in accordance with its plain and ordinary meaning unless it is given some special or technical meaning. *Stewart Title Co. v. Herbert*, Cal. Ct. App., 85 Cal. Rptr. 654 (1970); *Radio Corporation v. Philadelphia Storage Battery Co.*, Del. Supr., 6 A.2d 329 (1939). The meaning of ambiguous language may be ascertained by the manner in which

the parties operated under the contract. 3 Corbin, *Contracts* §558 (1960); *Artesian Water Co. v. State, Department of Highways & Transportation*, Del. Supr., 330 A.2d 441 (1974). Finally, where more than one interpretation is possible, the Court should adopt that which will produce a reasonable and equitable result. *Addiego v. Hill*, Cal. Ct. App., 48 Cal. Rptr. 240 (1966); *Investment Associates, Inc. v. Standard Power & Light Corp.*, Del. Ch., 48 A.2d 501 (1946), *aff'd*, Del. Supr., 51 A.2d 572 (1947).

Both parties also appear to acknowledge that the transfer provisions of Section 4 are ambiguous, at least as applied to the present controversy. If La Cadena had attempted to sell its restricted stock, there seems to be no question but that such a transaction would trigger the provisions of Section 4. La Cadena would be required to give a "Sell Notice" identifying the prospective purchaser and the stock purchase price (Section 4.3) and the other parties would have an option to purchase the offered shares (Section 4.4). However, assuming the Craig Agreement is a transfer of shares under Section 4.1, it is unclear how Sections 4.3 and 4.4 would operate where the transferee is not purchasing the stock but only acquiring some lesser interest in it. For example, Section 4.3 requires the sell notice to include the identity of the prospective "purchaser" and the "stock purchase price," a term defined to mean the amount in cash equal to the total cash and non-cash consideration to be paid by the prospective "purchaser" (Section 4.5). Thus, I start from the premise that Section 4 of the Stockholders' Agreement is ambiguous and must be construed in accordance with the general principles outlined above.

The Garrett Group argues that Section 4 was designed to carry out the parties' intent to maintain control of Stater Bros. within the original stockholder groups. The earlier stockholder agreements, in effect when the company was privately held, clearly reflect such a purpose and the evidence establishes that the Garretts wanted the post-public offering arrangement with La Cadena to preserve their or both groups' control. Before the Stockholders' Agreement was executed, the Garretts proposed a voting trust which, based upon the parties' combined holdings, could have guaranteed control. However, Brown was unwilling to enter into a voting trust and there is nothing in the Stockholders' Agreement that purports to prevent either side from acquiring 51% of the stock through open market purchases and thereafter voting its stock to oust the other side. Thus, to the extent that the Garrett Group suggests that the Stockholders'

Agreement was intended to preserve the parties' relative control positions or prevent either side from obtaining control, its articulation of purpose is too broad.

On the other hand, the evidence and the Stockholders' Agreement itself indicate that the parties did intend a similar but more limited purpose. Both Mitchel Garrett and Brown understood that, at least, their agreement was intended to prevent them from selling out to a third person without first allowing the other stockholder to buy the restricted shares. The parties also agree that the broad definition of "Transfer" was intended to prevent either stockholder from placing restricted shares in the hands of an outsider through a device other than an outright sale.

The word "Transfer" is defined in Section 1 of the Stockholders' Agreement to mean, "a sale, assignment, hypothecation, encumbrance, bequest or other transfer, whether by operation of law or otherwise." Thus, it is agreed that a pledge of restricted shares to collateralize a loan, for example, would constitute a prohibited transfer under Section 4.1. Indeed, both parties' conduct in obtaining financing for the proxy fight confirms this interpretation of the Stockholders' Agreement. The loan documents in both cases specifically exclude the restricted stock from the pledged collateral and include provisions requiring the borrower to pledge the restricted stock at such time as it may be encumbered without violating the transfer restrictions in the Stockholders' Agreement. *See*, Trust Stock Agreement of Union Bank Agreement, §1; Security Pacific Credit Agreement, §6.9. I conclude from the foregoing that the parties intended to establish some control against transfers other than sales.

This determination of the parties' general intent with respect to transfers, however, does not advance the analysis very far. There remains a problem of attempting to reconcile the seemingly broad prohibition contained in Section 4.1 with the arguably more limited rights provided in Section 4.4. More specifically, Section 4.1 prohibits the transfer of any stock or "any right, title and interest therein or thereto" except with the consent of the other stockholders or in accordance with Section 4. However, the description of the Sell Notice to be used in connection with the purchase option, as noted earlier, is written in terms of a sale— *e.g.*, "Sell Notice," "purchaser," and "Stock Purchase Price."

Moreover, the "Stock Purchase Price" is defined as that amount in cash equal to the sum of the total consideration " *to be paid* by the prospective purchaser. . . *for the Offered Shares*. . ." (emphasis

added) plus the total consideration to be paid to any of the stockholder group members or affiliates for any management, consulting or employment agreement entered into in connection with the transfer (Section 4.5). This language does not readily suit itself to a pledge of restricted stock as collateral for a loan. The lender is not proposing to pay for the offered shares in such a transaction. Rather it is holding the stock as collateral to secure its investment in the event of a default. In addition, the total consideration to "be paid" by the lender could be significantly less than the fair market value of the pledged stock. In such a case, the stockholder exercising its purchase option would be acquiring the stock at a fraction of its true value. This problem is magnified in the case of a bequest (which is included in the definition of transfer) where the legatee may not be paying anything for the stock.

The Garrett Group contends that just such a result was intended by the parties. Mitchel Garrett testified that the transfer restrictions were designed to prevent one of the stockholders from using its restricted stock to leverage the acquisition of sufficient publicly held shares to gain control. In those circumstances, the type of right of first refusal contained in the earlier stockholders' agreements—where the non-transferring stockholder had the right to "stand in the shoes" of the transferee—would only "enable" the non-transferring stockholder to finance its loss of control. To avoid this result, the previous right of first refusal was recast as a purchase option.

[6] Mitchel Garrett, an attorney who is not practicing law, testified that the stock purchase price in the case of a pledge would be the fair market value of the affected shares. Mr. Zweig, the attorney who drafted the Stockholders' Agreement, took a different view (the one adopted by the Garrett Group)—that the stock purchase price would be the value of the loan or other non-sale transfer. He recognized that his interpretation could result in the forced sale of the restricted shares at a commercially unreasonable price. However, the affected stockholder could avoid this hardship by not transferring its stock.

The Brown Group seizes upon these difficulties in arguing against the Garretts' interpretation of Section 4. It points out that there is no evidence that the applicability of the purchase option mechanism to a loan was ever discussed by the parties or their attorneys. The Brown Group argues that the Garrett Group is contorting the language of Section 4 to effect a purpose that was specifically rejected by Brown before the agreement was executed. Garrett had wanted

a voting trust to assure his control after the company went public. Brown refused. The result was an agreement providing no protection against the purchase of control by either of the parties. The Brown Group also notes that Section 4, as construed by the Garrett Group, operates as a partial forfeiture in the case of a pledge or other transfer of a partial interest in the restricted shares. Forfeitures are not favored and contracts will be construed to avoid such a result. *Petrovich v. City of Arcadia*, Cal. Supr., 222 P.2d 231 (1950); *Clements v. Castle Mtg. Serv. Co.*, Del. Ch., 382 A.2d 1367 (1977).

The Brown Group's contention that the purchase option applies only to sales and not other transfers of restricted shares is also somewhat flawed. If, as it concedes, Section 4.1 prohibits certain non-sale transfers but Section 4.4 only applies to outright sales, then there is a gap in the protection afforded to the stockholders. The Garrett Group says that it is unreasonable to construe Section 4 as having created a remedy which is not coextensive with the transfer restriction. The Brown Group's response—that the third party takes with notice of the restrictions and the aggrieved stockholder may sue—does not fully meet the Garrett Group's objection. Although other remedies may be available, the fact remains that, under the Brown Group's interpretation, the purchase option mechanism would not apply to all prohibited transfers. As a result, it would not fully effectuate the purpose of preventing the stockholders from selling out to third parties.

[7,8] In construing Section 4, the principle that all provisions in a contract should be given effect in accordance with the parties' intent must be balanced against the premise that the Court will not rewrite a contract to add provisions not included by the parties. *Sayble v. Feinman*, Cal. Ct. App., 142 Cal. Rptr. 895 (1978); *Gertrude L. Q. v. Stephen P. Q.*, Del. Supr., 466 A.2d 1213, 1217 (1983); *In Re International Re-Insurance Corp.*, Del. Ch., 86 A.2d 647 (1952). Notwithstanding the parties' general intent, I conclude that it would require inappropriate judicial reformation of the contract to read the purchase option provisions as applying to non-sale transfers. In cases of conflict, specific provisions are construed as a limitation on more general provisions. *Sanserino v. Shamberger*, Cal. Ct. App., 54 Cal. Rptr. 206 (1966); *Wood v. Coastal States Gas Corp.*, Del. Supr., 401 A.2d 932, 941 (1979) [citing *Restatement of Contracts* §236(c) (1932)]. Here, a specifically defined purchase option mechanism is established in conjunction with the general prohibition against transfers. The purchase option mechanism could not be applied to most types of

non-sale transfers without straining the meaning of the language used. In the case of a bequest, the language would have no meaning at all, for there would be no "stock purchase price" to be paid by the transferee.

Although this interpretation does not provide the parties with complete contractual protection against transfers to outsiders, it is not unreasonable or unfair. They still have recourse to the available equitable and legal remedies as to any non-sale transfers. The alternative construction, on the other hand, is untenable in light of the provisions adopted and would be inequitable in those cases where it would result in a partial or total forfeiture.

Turning now to the Craig Agreement, the first issue is whether it constitutes a transfer of restricted shares under the Stockholders' Agreement. The Garrett Group argues that the Craig Agreement transferred various rights in and to the restricted stock in violation of Section 4.1. First, Craig may require La Cadena to reduce Craig's average cost in acquiring the Stater Bros. stock to $15 per share. [Election (i)]. That election could involve the transfer of La Cadena's stock, including restricted shares, to Craig at no cost or at a price less than $15 per share. Second, Craig could require La Cadena to purchase Craig's Stater Bros. holdings by use of a convertible purchase money promissory note. [Election (iii)]. Under that election, La Cadena would be required to secure the note, to the extent possible, by a pledge of that amount of Stater Bros. stock into which the note is convertible. Again, the pledge could involve the restricted shares. Third, if the parties' combined holdings constitute control of Stater Bros., Craig and La Cadena agreed to equalize their stock holdings through a transaction which could involve the sale of Stater Bros. stock by La Cadena to Craig. (Craig Agreement, ¶(b), p. 3-4). Fourth, the parties granted each other rights of first refusal expressly subject only to La Cadena's existing bank pledge agreement. (Craig Agreement, ¶(i), p. 4).

The Brown Group responds that none of the transactions contemplated in the Craig Agreement constitute a present transfer of restricted shares. As a general matter, it relies upon the undisputed testimony that the parties to the Craig Agreement did not intend any of its provisions to require the transfer of restricted shares. Focusing on Election (iii), the provision pursuant to which the Garretts claim beneficial ownership of 400,000 shares, the Brown Group notes that the Craig Agreement expressly recognizes the potential impact of the Stockholders' Agreement and provides that a "rea-

sonable period of time and a reasonable amount of cooperation on the part of Craig" may be necessary to carry out that election. In addition, the note under Election (iii) was to be secured "to the extent possible" by a pledge of La Cadena's stock. This language is consistent with the parties' testimony as to their intent not to transfer restricted shares. Moreover, even if Election (iii) were implemented and if there were no understanding that restricted shares would not be involved, it does not necessarily follow that any restricted shares would be required to satisfy the pledge. La Cadena and its partners hold a total of 274,146 unrestricted shares and, under Election (iii) Craig would be transferring to La Cadena as much as 285,950 shares. If the La Cadena Group's stock were unencumbered at the time of the election, there would be no need to resort to restricted shares to collateralize the note.

The Brown Group follows a similar line of analysis with respect to the other provisions in the Craig Agreement. It argues that each of the purported transfers either is not a "transfer" within the meaning of the Stockholders' Agreement or would not require the use of restricted shares. With respect to the right of first refusal, the evidence is that it was understood that such a right would be subject to the Garretts' prior right of first refusal if restricted shares were involved.

The Garrett Group contends that this Court should ignore the Brown Group's self-serving testimony as to the intent of the Craig Agreement. It argues that La Cadena and Craig were trying to "get around" the Stockholders' Agreement and should not be allowed to succeed in that effort. As to the intent of the parties to the Craig Agreement, I see no reason why their testimony should not be accepted. La Cadena and Craig certainly are self-interested but, from the very outset, it was in their self-interest to reach an agreement that would not violate the Stockholders' Agreement. As to La Cadena's desire to circumvent the restrictions in the Stockholders' Agreement, it must be borne in mind that both sides were in the market attempting to acquire enough stock to gain control. The fact that the La Cadena Group was successful by virtue of its arrangements with Craig is of no consequence unless La Cadena's restricted shares were transferred in the process.

[9] The Craig Agreement is a letter agreement, which by its terms, contemplates further negotiation and refinement by the parties depending upon future events. Given that this was not an integrated contract fully setting forth the parties' respective rights and obli-

gations, it is most appropriate to interpret the Craig Agreement, as the parties did, as not involving the transfer of restricted shares. *See*, 4 *Williston on Contracts*, §605; *Campbell v. Rockefeller*, Conn. Supr., 59 A.2d 524 (1948).

This interpretation does no violence to any of the provisions of the Craig Agreement. As the Garrett Group acknowledges, Election (i) could be accomplished without the use of any restricted shares. The same result is possible under Election (iii). The agreement to equalize La Cadena and Craig's holdings specifically recognizes that the mechanics for such a transaction would have to be negotiated as well as the possibility that the parties would be unable to achieve their objective. In that event, the Craig Agreement provides that each of the parties would be free to continue to hold or dispose of their stock as their interests may require. Thus, this "transfer," too could be accomplished without the use of restricted shares or abandoned altogether.

The right of first refusal, if read in accordance with the parties' intent, would be exercisable after the Garretts' right of first refusal under the Stockholders' Agreement. Pursuant to Section 4.9 of the Stockholders' Agreement, if the purchase option were not exercised, La Cadena would be free to sell the offered shares to a third party. Other provisions as to the manner in which La Cadena will vote its stock cannot reasonably be construed to constitute a transfer under the Stockholders' Agreement. As noted earlier, the Stockholders' Agreement does not in any way limit the stockholders' freedom to vote their shares as they see fit. That being the case, it would be inappropriate to read the definition of transfer to include a voting agreement.

Based upon the foregoing, I conclude that the election results, as tallied by the inspectors, should be certified and Messrs. Wallace, Carr and Matich have been duly elected directors of Stater Bros. In reaching this conclusion I have not addressed the inspectors' failure to count a Bear, Stearns & Co. proxy for 10,000 shares that the Garrett Group contends should have been voted for its nominees. The validity of that proxy would not affect the election results and, therefore, determination of that issue is not necessary to this decision.

Finally, the Brown Group's prayer for ancillary relief, which was predicated upon a determination that its nominees were elected, will be addressed briefly. On May 2, 1986, four days after the election, the Brown Group called a meeting of directors at which the company's officers were removed and replaced and the board's

committees were reconstituted. The Brown Group asks the Court to rule on the validity of the May 2 meeting or provide for the calling of a board meeting within 48 hours after the entry of an order determining the election results. In addition, the Brown Group asks that the provisions of an interim order dated May 8, 1986 concerning payments under an Indemnification Trust be continued in effect for 45 days and be supplemented by a similar provision concerning payments scheduled to be received by Hampshire National under an irrevocable letter of credit.

After considering these requests, I find that it would create unnecessary uncertainty to rule on the validity of the May 2 meeting when the Garrett Group has remained in control of Stater Bros. throughout these proceedings. If the May 2 meeting were declared valid, questions would undoubtedly arise as to whether any actions taken by the Garrett Group after May 2 are valid and binding on the corporation. I, likewise, see no reason why the provisions of an interim order or other similar provisions should be included in a final order as long as a mechanism is established for the prompt and orderly transfer of control. I request counsel for the Brown Group to submit a form of order, on notice, at their earliest convenience.

GILBERT v. EL PASO

Nos. 7075 & 7079

Court of Chancery of the State of Delaware, New Castle

June 17, 1986

Plaintiffs brought a class action on behalf of shareholders of the El Paso Company who had tendered their shares to Burlington Northern, Inc., which had previously made a hostile tender offer for El Paso stock. Burlington withdrew its offer after it reached an