47% of their shares while retaining 53% of their investment. If management's view of the beneficial effect of the ESOP is correct, then over the long-term those shares will increase in value. In any event, at the present time no better available economic alternative has been shown to exist.

* * *

Because the plaintiff has failed to establish a likelihood of ultimate success on either of his claims, or to show a threat of irreparable harm, *Gimbel v. Signal Cos. Inc.*, Del. Ch, 316 A.2d 599, 602-603 (1974), his motion for a preliminary injunction is denied. IT IS SO ORDERED.

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## MUTUAL SHARES CORP. v. TEXAS AIR CORP.

No. 8650 (Consolidated)

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

September 30, 1987

Pursuant to a settlement agreement involving three consolidated stockholder class action suits, the court of chancery determined the amount and distribution of award in this cross application for attorneys' fees. Vice-Chancellor Hartnett reduced the amount sought by plaintiffs to $3 million, recognizing the contribution to this settlement of another law firm involved in a companion case, and discounting the net value of the settlement claimed by plaintiffs. The court ordered that $120,000 of the award be paid to plaintiffs' former counsel, who had not participated in the settlement negotiations but had nonetheless impacted on the ultimate settlement.

1. Corporations ⟹ 214

Plaintiff's counsel is entitled to attorney's fees and costs where the suit was meritorious when filed, action producing benefit to the corporation was taken by the defendants before a judicial resolution was achieved, and the resulting corporate benefit was carefully related to the lawsuit.

2. Corporations ⟹ 214

The law presumes a causal connection between plaintiff's efforts and the benefits where a suit is settled.

3. Corporations ⟹ 214

The legal presumption of a causal connection between plaintiff's efforts and the benefits where a suit is settled is rebuttable.

4. Corporations ⟹ 214

In determining the amount of attorney fees to be awarded where a case is settled, the court must consider whether the benefits were achieved as the result of plaintiff's litigation, whether the attorney fees are reasonable considering the value of the benefit actually achieved, and the other factors usually considered when attorney fees are awarded.

5. Corporations ⟹ 214

The claim of a law firm that took over representation after another firm had performed services that it was entitled to the same percentage of the value of a settlement just as if no other firm had been involved because they were the sole representatives for plaintiffs at settlement negotiations is not supportable where the settlement would likely not have occurred except for the work of the former firm.

6. Corporations ⟹ 214

Where employee shareholders received some benefit in a settlement in the form of an option valued less than the settlement payment to other shareholders, the value of the settlement must be discounted

for the purpose of determining attorneys' fees to more accurately reflect the true benefits received.

7. Corporations ⟹ 214

The value of a settlement for the purpose of considering attorneys' fees is based on the amount per share being paid pursuant to the court-approved settlement agreement, and did not consider an increase in the tender offer price from an earlier proposal where the increase was primarily due to market factors.

Joseph A. Rosenthal, Esquire, and Carolyn D. Mack, Esquire, of Morris and Rosenthal, P.A., Wilmington, Delaware; and Tenzer, Greenblatt, Fallon & Kaplan, P.C., New York, New York, for plaintiffs Mutual Shares Corporation and James J. Baltz.

Thomas G. Hughes, Esquire, of Hughes & Sisk, Wilmington, Delaware; and Harvey Greenfield, Esquire, of New York, New York, for plaintiff Morris Kronfeld.

Jesse A. Finkelstein, Esquire, and E. Norman Veasey, Esquire, of Richards, Layton & Finger, Wilmington, Delaware; and Vinson & Elkins, of Texas, for American General Corporation and American General Life Insurance Company.

Bruce M. Stargatt, Esquire, and Josy W. Ingersoll, Esquire, of Young, Conaway, Stargatt & Taylor, Wilmington, Delaware; for defendant Continental Airlines, Inc.

Paul P. Welsh, Esquire, and Palmer L. Whisenant, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for defendant Texas Air Corporation.

HARTNETT, *Vice-Chancellor*

Three stockholder class action suits were filed in this Court and subsequently consolidated. Each attacked a going-private merger whereby Continental Airlines, Inc. ("Continental") was merged into a wholly owned subsidiary of Continental's parent Texas Air Corporation ("Texas Air"). This consolidated action was then settled by the parties and the settlement was approved by the Court on May 27, 1987. Pursuant to the Settlement Agreement each stock-

holder of Continental at the time of the merger will receive an additional $3.75 per share.

Also as part of the Settlement Agreement, defendants Texas Air and Continental agreed to pay whatever attorney fees this Court approves on behalf of the plaintiffs. The amount of attorney fees to be approved by the Court, and the division of the fees, are disputed.

I find that plaintiffs should receive $3 million as attorney fees to be paid by Texas Air and Continental: $120,000 to Harvey Greenfield and Hughes and Sisk and the balance to Morris & Rosenthal and Tenzer, Greenblatt, Fallon & Kaplan.

I

On March 5, 1986, Civil Action #8406-NC was filed by Harvey Greenfield of the New York bar and his then Delaware associates Morris and Rosenthal, P.A., on behalf of Morris Kronfeld. Subsequently, Hughes & Sisk of the Delaware Bar replaced Morris and Rosenthal. (Hughes & Sisk and Mr. Greenfield are hereafter collectively referred to as "Hughes and Sisk".) On September 29, 1986, Civil Action #8650-NC was filed by Morris and Rosenthal, P.A. of the Delaware bar and Tenzer, Greenblatt, Fallon & Kaplan of the New York bar (collectively "Morris & Rosenthal") on behalf of Mutual Shares Corporation; on January 16, 1987, Civil Action #8805-NC was filed by Morris and Rosenthal, P.A. and Tenzer, Greenblatt, Fallon & Kaplan of the New York bar on behalf of James J. Baltz, et al.

Prior to any of these actions being filed, however, on February 20, 1986, Civil Action #8390-NC was filed by Richards, Layton & Finger of Delaware and Vinson & Elkins of Texas (collectively referred to as "Richards, Layton & Finger") on behalf of American General Corporation, et al ("American General"). This was, therefore, the first filed action which sought to enjoin the going-private merger. In that suit American General also raised an issue not raised in the other suits: an alleged right of American General to enforce certain option provisions in stock warrants it held. Otherwise, the allegations in the American General suit were basically the same as the allegations in the three subsequently filed suits.

American General did not bring its action as a class action nor was its suit formally consolidated with the other suits but the discovery in all four cases was conducted as if they had been consolidated, and all four applications for a preliminary injunction were held simultaneously and were denied by me on February 5, 1987.

After the denial of the preliminary injunction, Civil Action Nos. 8406, 8650 and 8805 were settled. The American General suit (C.A. #8390) remains active.

All agree—including the Court—that the counsel for American General had the primary responsibility for the discovery and for the presentation of the applications for a preliminary injunction. Defendants claim that the award of attorney fees in Civil Action Nos. 8650, 8805 and 8406 should be less than plaintiffs seek in order to reflect the work done by counsel for American General and should also be reduced for other reasons. I agree that some reduction from the fees sought must be made. There is also a dispute as to how the attorney fees should be divided.

II

Morris and Rosenthal and their clients seek $5.4 million as attorney fees which they assert is 13% of the gross value of the settlement and 15% of the net value. Harvey Greenfield and Hughes & Sisk and their client seek $6 million. All the plaintiffs concede, however, that but one attorney fee should be awarded and Morris and Rosenthal and Hughes & Sisk both seek the entire award.

Defendants, while acknowledging that an award of attorney fees should be made, dispute the total amount of attorney fees to be awarded and plaintiff's claim as to the value of the settlement and assert that the bulk of the award should go to Morris and Rosenthal.

All the counsel for plaintiffs assert that an award of counsel fees of 15% of the net value of a settlement in a stockholder class action has not been unusual in these types of cases. This, however, ignores the fact that this class action settlement is atypical and there are a number of reasons why the attorney fees awarded must be less than the amount sought.

The total value of the settlement is larger than many other similar cases; it is also less than the plaintiffs claim. The attorney fees will not be paid out of the settlement fund but will be paid separately by defendants, who vigorously object to the size of the request and, most importantly,. a large portion of the legal work which ultimately led to the settlement was performed by a law firm in a companion suit which has not been settled.

The issue of the distribution of the attorney fees is also subject to a dispute because the attorneys who represent the various plaintiffs unfortunately cannot agree as to how the fees are to be shared.

III

[1-4] Both Morris and Rosenthal and Hughes & Sisk urge that without their efforts the settlement would not have occurred and therefore they each assert that their claims for attorney fees should not be reduced because of the work performed by Richards, Layton & Finger in Civil Action #8390. In *Allied Artists Pictures Corp. v. Baron*, Del. Supr., 513 A.2d 876 (1980), the Court stated:

> . . . [P]laintiffs' counsel would be entitled to attorneys' fees and costs where: the suit was meritorious when filed; action producing benefit to the corporation was taken by the defendants before a judicial resolution was achieved; and the resulting corporate benefit was carefully related to the lawsuit."

And the law presumes a causal connection between plaintiffs' efforts and the benefits where a suit is settled. *McDonnell Douglas Corp. v. Palley*, Del. Supr., 310 A.2d 635 (1973). This presumption, however, is rebuttable. *Cf. Maldonado v. Flynn*, Del. Ch., C.A. No. 4800-N.C., Hartnett, V.C. (June 10, 1985); *Dann v. Chrysler Corp.*, Del. Ch., 215 A.2d 709 (1965), *aff'd*, Del. Supr., 223 A.2d 384 (1966). A presumption that plaintiffs' counsel is entitled to attorney fees where a case is settled also does not mean that there is a presumption that the attorney fees should be whatever plaintiff requests. The Court must consider whether the benefits were achieved as the result of plaintiff's litigation and if so whether the attorney fees are reasonable considering the value of the benefit actually achieved and the other factors usually considered when attorney fees are awarded. *In Re Beatrice Co., Inc. Litigation*, Del. Ch., C.A. No. 8248-N.C., Allen, C. (April 16, 1986); *In Re Maxxon Group, Inc.*, Del. Ch., C.A. No. 6343-N.C., Allen, C. (April 16, 1987); *Rosen v. Smith*, Del. Ch., C.A. No. 7863-NC, Hartnett, V.C. (Sept. 18, 1985).

The actual negotiations which led to the settlement were negotiated solely between Morris and Rosenthal and the attorneys for defendants. It is therefore undoubtedly true that without Morris and Rosenthal's negotiations with defendants, a settlement would not have occurred because obviously there cannot be a negotiated settlement without opposing parties to negotiate.

It is also abundantly clear, however, that without the work of Richards, Layton & Finger, the presentation of the applications for a preliminary injunction would have been much weaker because it was Richards, Layton & Finger who did all the considerable discovery

and prepared exhaustive briefs. Although I denied the application for the preliminary injunction in *American General Corp. et al. v. Texas Air Corp., et al.*, Del. Ch., C.A. Nos. 8390, 8406, 8650 and 8805, Hartnett, V.C. (Feb. 5, 1987), I reviewed the contentions of the parties and indicated my view that there were several serious weaknesses in defendants' assertions. Certainly that decision contributed to the defendants' change of position in seeking a settlement and except for Richards, Layton & Finger's work and the court's ruling, the settlement would also likely not have occurred.

[5] Plaintiffs' claim that they are entitled to the same percentage of the value of the settlement just as if no other law firm performed any of the legal work, because they were the ones who were on the scene at the settlement negotiation sessions is not supportable.

## IV

Defendants, in opposing the plaintiffs' applications, first urge that the total amount of attorney fees to be awarded must be less than the $6 million requested because this sum is based on a claim that it is approximately 15% of $41 million, which plaintiffs claim is the value of the settlement. Defendants however claim that the value of the settlement is considerably less.

One of the reasons for the difference of opinion as to the value of the settlement arises because the plaintiffs compute the class benefit on the basis of 7,200,000 shares. The owners of 1,000,000 shares, however, are employees of Continental who are denied the settlement payment unless they waive a Special Employee Option which provides that eligible employees remain employed with a Texas Air affiliated corporation for 18 months after the merger.

This Employee Option is now worth approximately $10 per share over the settlement payment and therefore it must be assumed that many of the employees will not elect to waive their option rights and receive the settlement benefit. Defendants assert that there is no value from the settlement to these employees and therefore the value of the settlement must be reduced by $3.75 million for the purpose of computing the attorney fees.

Plaintiffs, however, argue that the employees did benefit from the settlement because the option is contingent upon several factors—including that an employee continue to remain employed by a Texas International affiliated airline for 18 months and that it is not even in full effect. They also point out that as a result of the settlement the employees now have two options: to take the extra $3.75 being

paid in the settlement, or to wait and exercise the options after they come into existence at some future date.

[6] I find that the employees received some benefit from the settlement because they now have another valuable option, but that the value of the settlement to the 1,000,000 shares owned by the employees is not the full $3.75 per share and, therefore, the value of the settlement must be discounted.

V

[7] There is also contention about the true value of the settlement to the stockholders. The settlement which was approved by the Court provides for an additional payment of $3.75 per share to all stockholders of record as of the time of the cash-out merger. Plaintiffs, however, claim that the actual benefit to the class is $5.05 per share because the tender offer price in the tender offer which was challenged in these suits was $1.30 more than defendants originally offered in an aborted offer made before these suits were filed. Defendants respond that the value of the settlement, for purposes of considering the amount of attorney fees, should be based only on the $3.75 extra paid to the stockholders in the settlement.

I find that the value of the settlement for purpose of considering the attorney fees of the present applicants should be based on the $3.75 per share being paid. The applicants had little or nothing to do with the $1.30 increase in the tender offer price from the earlier proposal until its final version. The increase in price was primarily due to market factors. And, if any attorneys caused an increase in the tender offer price, it was Richards, Layton & Finger, not the attorneys now seeking attorney fees.

VI

Plaintiffs cite several cases where the attorney fees awarded equalled or exceeded 15%. Most of these cases, however, involved a much smaller total recovery and none of them had critical participation by a law firm which was not seeking part of the attorney fee award.

After considering all the facts and circumstances, I find that the total attorney fees to be awarded should be $3 million to be paid, as agreed, by defendants.

VII

Perhaps the most distasteful part of this brouhaha over attorney fees is the existence of cross applications for the same fees.

The failure of plaintiffs' counsel, who were once allies in this litigation, to agree as to the sharing of the attorney fees demonstrates a disturbing lack of professionalism on someone's part. Compare DR-2-107.

Even more disturbing are the allegations of impropriety which defendants assert against plaintiffs' counsel and the conflicting statements made by Morris and Rosenthal, P.A. and Harvey Greenfield as to exactly what transpired. The claim of impropriety arises because Tenzer, Greenblatt, Fallon & Kaplan, P.C. of the New York Bar (who are associated with Morris and Rosenthal, P.A. in C.A. 8650 and C.A. 8850) entered an "Of Counsel" appearance in Civil Action 8406 (*Kronfield v. Texas Air Corporation*). Harvey Greenfield of the New York Bar, who was formerly associated with Morris & Rosenthal in the Kronfield case but is now associated with Hughes & Sisk in that case and who has always represented plaintiff Kronfield in this litigation, denies that he or his client consented to the "Of Counsel" appearance. Mr. Rosenthal says he did.

Without setting forth all the charges and countercharges, suffice it to state that it is impossible for me to determine from the present record who is being truthful, although it is clear someone is not being truthful. I, therefore, find that defendants have not sustained their burden of showing that any unethical practice occurred, although the circumstances are indeed unusual—or even bizarre.

If defendants believe that an unethical act has occurred they should (and must) pursue the matter in the appropriate forum, but I cannot find from the present record that the conduct should affect the attorney fees being awarded.

VIII

It is also asserted by defendants that Harvey Greenfield (who, as previously stated, is now associated with Hughes & Sisk although he was formerly associated with Morris and Rosenthal, P.A. in the Kronfield litigation) should receive little or no portion of the attorney fees being awarded because he did little or nothing to cause the settlement. As previously indicated, Mr. Greenfield filed the first of the three suits being settled. It is also clear, however, that his suit remained relatively inactive until the American General Life Insur-

ance Co. suit (C.A. #8390-NC) began to proceed with its massive activity, and he, for the most part, merely sat in on some of the depositions taken by others. He did, however, appear at the preliminary injunction hearing and submitted a short brief which, in effect, summarized the many arguments made by Richards, Layton & Finger on behalf of American General. He subsequently was precluded from participating in the settlement negotiations because defendants assert that by that time they did not perceive him as being credible.

Defendants and Morris and Rosenthal, P.A. assert that Mr. Greenfield and his Delaware associates, Hughes & Sisk, should be awarded no portion of the attorney fees or only a small part. Mr. Greenfield, however, claims he is entitled to the entire $6 million attorney fee he has requested—apparently on the sole basis that his suit was the first filed of the suits settled.

I find that Mr. Greenfield's services had only minimal impact on the ultimate settlement and he therefore shall be entitled to $120,000 from the total attorney fees awarded, which is probably more than his work justifies.

In making this award, I find that Mr. Greenfield had some impact on the ultimate settlement because he did file the first suit of the three suits settled and he did participate in the discovery and the preliminary injunction hearing. I also find that his brief at the preliminary injunction hearing was useful to the Court despite defendants' contempt for it. His brevity, instead of necessarily indicating incompetence, may have demonstrated astuteness because an unduly lengthy brief often merely indicates the lack of time or ability to prepare a more concise document.

# PAN OCEAN NAVIGATION, INC. v. RAINBOW NAVIGATION, INC.

No. 8674

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

July 8, 1987

Plaintiff, a Nevada corporation wholly owned by a trust, instituted an action to examine the books and records of defendant, a Delaware corporation, which maintained no stock ledger as contemplated by sections 219 and 220 of the Delaware General Corporation Law. DEL. CODE ANN. tit. 8, §§ 219, 220 (1983).

The court of chancery, per Chancellor Allen, after trial, decided the plaintiff, even though not a stockholder of record is entitled in equity to inspect the defendant's books and records where: (1) plaintiff is wholly owned by the trust and defendant concedes the trust is a stockholder of record; (2) defendant did not attain a valid security interest in the stock held by the trust; and (3) even if a valid security interest was held by defendant corporation, such security interest was not validly foreclosed upon, thus preserving the inequitable status of plaintiff.

1. Corporations ⟹ 181(1), 181(3)

Section 220 of the Delaware General Corporation Law affords to stockholders a right, upon making a demand in the proper form, to inspect a corporation's books and records for any proper purposes. DEL. CODE ANN. tit. 8, § 220 (1983).

2. Corporations ⟹ 181(1), 181(3), 181(8)

It would be inequitable to foreclose all persons from the rights afforded by section 220 simply because no person was registered as a stockholder on the company's ledger; in such a situation, a trial is necessary to determine which stockholders would be considered, in equity, stockholders of record for section 220 purposes. DEL. CODE ANN. tit. 8, § 220 (1983).

3. Corporations ⟹ 171, 181(1), 181(3)

Once the court is forced to inquire into the underlying facts concerning stock ownership because the corporation has maintained no stock ledger, there is little or no continued utility in insisting that a valid demand is one made by a shareholder rather than a wholly-owned subsidiary of the shareholder. DEL. CODE ANN. tit. 8, §§ 219, 220 (1983).

4. Corporations ⟹ 471

Generally, a certificated security is evidenced by an instrument issued in bearer or registered form; an uncertificated security is a share or other ownership interest in a corporation not evidenced by an instrument, but rather it is essentially a book entry on the issuer's stock ledger. DEL. CODE ANN. tit. 6, § 8-102 (1983).

5. Corporations ⟹ 472

Transfers of interest, including security interests, in uncertificated securities may be effected by registration. DEL. CODE ANN. tit. 6, § 8-108 (1983).

6. Secured Transactions ⟹ 2

Article 9 of the Delaware Uniform Commercial Code generally governs the creation, perfection, and enforcement of security interests in property and applies to any transaction (regardless of its form) which is intended to create a security interest in personal property including instruments and general intangibles. DEL. CODE ANN. tit. 6, § 9-102(1)(a) (1983).

7. Corporations ⟹ 474

In a situation involving an uncertificated security in which no registration of a pledge was made on the issuer's books, the purported pledge is not enforceable unless there is a writing signed by the owner of the collateral reasonably identifying the property subject to the lien.

8. Secured Transactions ⟹ 43

The description of collateral in a security agreement should be written with reasonable clarity so that those with an interest in the

matter, potential future lenders and reviewing courts, need not hazard a guess as to just what property was intended to be covered.

9. Secured Transactions ⟹ 230, 239

The holder of a valid security interest, in order to foreclose upon that interest, must comply with the requirement of section 9-505(2) which requires a secured party in possession of collateral to give notice to a debtor of an intention to retain the collateral in satisfaction of the debt in default. DEL. CODE ANN. tit. 6, § 9-505(2) (1983).

10. Secured Transactions ⟹ 239

The issuer of uncertificated stock, with the concomitant power to unilaterally transfer legal title to it stock, is in possession of its own stock for purposes of section 9-505(2). DEL. CODE ANN. tit. 6, § 9-505(2) (1983).

11. Secured Transactions ⟹ 229, 231

When the rights of no third party purchaser from a secured party in possession intervene, failure to comply with the requisites of section 9-505(2) should be read to preclude the effectiveness of a purported foreclosure. DEL. CODE ANN. tit. 6, § 9-505(2) (1983).

Edward P. Welch, Esquire, and Andrew J. Turezyn, Esquire, of Skadden, Arps, Slate, Meagher & Flom, Wilmington, Delaware; and William P. Frank, Esquire, and Richard S. Simon, Esquire, of Skadden, Arps, Slate, Meagher & Flom, New York, New York, for plaintiff.

John H. Benge, Jr., Esquire, of Allmond, Eastburn and Benge, Wilmington, Delaware; and Theodore W. Rosenak, Esquire, of Zuckert, Scoutt, Rasenberger & Johnson, Washington, D.C., of counsel, for defendant.

ALLEN, *Chancellor*

[1] Section 220 of the Delaware General Corporation Law affords to stockholders a right, upon making a demand in the proper form, to inspect a corporation's books and records for any proper

purpose. The myriad cases enforcing or refusing to enforce rights claimed under that provision of law deal largely with the question whether a proper purpose for such inspection has been shown. Whether the person asserting the right of inspection is a stockholder entitled to such an inspection is a question that has engendered very little litigation because the statute contains a clear and easily applied test. Subsection (a) of section 220 provides that "as used in this section, 'stockholder' means a stockholder of record." And the "record" referred to is identified with equal clarity. Section 219(c) provides that "the stock ledger shall be the only evidence as to who are the stockholders entitled to examine. . .the books of the corporation."

This books and records case is unusual in that there is no issue concerning either the propriety of the asserted purpose of the inspection or the formal correctness of the demand. Rather, the ultimate issue is whether plaintiff occupies a status entitling it to rights under section 220. That issue is not easily resolved by the clear language of Section 219 because the defendant has maintained no stock ledger and thus, of course, plaintiff is not a stockholder of record as defined by that section.

[2] Earlier in this litigation, defendant, Rainbow Navigation, Inc., moved for a summary judgment of dismissal on the ground that plaintiff, Pan Ocean Navigation, Inc., was not a Rainbow "stockholder." In denying that motion, the court acknowledged the utility of a strict construction of the statutory langauge limiting rights under section 220 to persons registered as stockholders on a corporation's stock ledger:

> Corporations ought not have to guess as to the identify of the person making demand nor, under the statute, should a corporation be put to the expense and trouble that would be occasioned by an investigation into such a person's status. The statute's requirements. . .provide a quick, fair and dependable way for the company to evaluate that aspect of a demand.

*Pan Ocean Navigation, Inc. v. Rainbow Navigation, Inc.*, Del.Ch., Allen, C., Civil Action No. 8674 (February 18, 1987). The corporation's motion was nevertheless denied. It was held that it would be inequitable to foreclose all persons from the rights afforded by section 220 simply because no person was registered as a stockholder on the company's stock ledger. The corporation's own inaction has deprived it, and this court, of the administrative benefits that the statutory scheme envisions. it was held that, in these circumstances, a trial

would be necessary to determine whether Pan Ocean should be deemed, in equity, a stockholder of record of Rainbow. That trial has now been held and this is the court's opinion in support of the conclusion that plaintiff is entitled to inspect the books and records of Rainbow as permitted to stockholders under section 220.

I.

Pan Ocean is a Nevada corporation wholly owned by a trust—a pension plan—established by a labor union. The trust is the Master, Mates and Pilots Individual Retirement Account Plan ("IRAP"). As of April, 1983, the IRAP entered into a discretionary Investment Management Agreement with Tower Asset Management, Inc. contemplating the investment by Tower Asset of the IRAP's trust funds or some of them. Tower Asset was one of three entities (the others being Tower Capital Corporation and Tower Securities Corp.) utilized by Andrew Levy and others in the conduct of business including serving as an investment advisor.

Rainbow is a Delaware company formed July 15, 1983 to engage in the business of operating a liner service, primarily carrying U.S. military cargos, between the United States and Iceland. Its certificate of incorporation authorized the issuance of 1,000 shares of common stock. According to Rainbow's then outside legal counsel[1] (PX 4), on March 1, 1984, 300 shares of Rainbow common stock were issued to HTI Ships, Inc. (a company controlled by Mr. Mark Yonge and Mr. Ted DeWitt) and 200 shares issued to Mr. N.H.S. Van Reesema.

Rainbow was in early 1984 little more than an idea in the mind of Mark Yonge. It needed seed money. On March 28, 1984 Rainbow entered into an agreement with Tower Asset providing that if Tower Asset purchased, on behalf of its clients, two $300,000 Rainbow debentures, the purchaser would be entitled to purchase 250 shares (out of 1,000) of Rainbow stock. Thereafter, the IRAP, acting through Tower Asset, lent $300,000 to Rainbow in the form of the purchase of a debenture.

On June 26, 1984 Tower Asset requested Rainbow's attorney to issue 250 shares "per the March 28, 1984 agreement" to the IRAP. On July 19, 1984 Rainbow's counsel prepared a certificate

1. I put the matter this way because I find in the record no corporate resolutions or minutes of board action relating to the issuance of any stock.

for 250 shares in the name of Tower Securities, Inc. Apparently for reasons relating to the federal ERISA statute (29 USC §1001 *et seq.*) Mr. Levy, as agent of the IRAP, determined it would be best for the IRAP's interest in Rainbow to be held through Pan Ocean, a corporation wholly owned by the IRAP. On July 25, 1984 Mr. Yonge, president of Rainbow, wrote to Rainbow's outside legal counsel as follows:

> I am returning share certificate no. 4 [for] 250 shares originally issued to Tower Securities, Inc. Please reissue shares in the name of Pan Ocean Navigation, Inc., address same as Tower in New York City.

No certificate was prepared by Rainbow's counsel in accordance with these instructions.

A document dated January 1, 1985 (the Shareholder Agreement) signed by Mr. Yonge for HTI Shipping, Mr. Van Reesema, and Mr. Levy (as president of Pan Ocean) set forth provisions governing the management of Rainbow. The Shareholder Agreement also provided:

> The parties agree and confirm that as of the date of this Agreement the stock of Rainbow is owned as follows:

| | |
|---|---|
| HTI | 450 shares |
| Van Reesema | 250 shares |
| Pan Ocean | 300 shares |

The Shareholder Agreement has not been amended or superseded nor has a material transfer of stock among those persons occurred.

Nevertheless, in August, 1985 Rainbow prepared two certificates for 150 shares each in the names of the IRAP and Tower Capital Corp. These certificates were not delivered to anyone but were kept in Rainbow's safe where they remain. It has been determined in litigation in the United States District Court for the Southern District of New York that no Tower entity has or had a beneficial interest in Rainbow but that any legal interest it may be deemed to have or have had is held for the benefit of the IRAP.

The foregoing constitute the facts relevant, in my opinion, to a determination of the question whether Pan Ocean may, in equity, be deemed a shareholder of Rainbow entitled to inspect its books and records. A second issue tendered by defendant is whether the interest in Rainbow owned by the IRAP through its investment

advisor or Pan Ocean was validly pledged and whether, if so, that pledge was effectively foreclosed terminating the IRAP direct or indirect equity interest in Rainbow. I will defer a statement of those facts now and will turn instead to the reasons I conclude that Pan Ocean is (or at all events was) an equitable stockholder of record of Rainbow.

II.

Rainbow's principal argument that Pan Ocean was never a Rainbow stockholder is that the IRAP was considered by everyone to be the shareholder and, it contends, that if the IRAP was the shareholder then Pan Ocean was not. Plaintiff denies the premise of this argument pointing to the Shareholder Agreement and the November 22, 1985 opinion of Rainbow's legal counsel (PX4) which treat Pan Ocean and not the IRAP as the shareholder, in support of that position.

I regard the attempted dichotomy between the IRAP and Pan Ocean as unhelpful in this setting where rights under section 220 are asserted and there is no stock ledger to resolve questions of record ownership. Indeed, the distinction between the IRAP and Pan Ocean, which may be very material in some contexts, is highly artificial in this setting. While the various participants sometimes referred to the shares as belonging to Pan Ocean and sometimes thought of or referred to them as the IRAP's, in the context in which most or all of the contemporaneous statements concerning stock ownership were made, a distinction between the IRAP and Pan Ocean was immaterial. For example, whether the successor investment advisor thought of the investment as being the IRAP's (which, of course, it was either directly or indirectly) and expressed this in a way consistent with their view that the IRAP was a "shareholder" deserves very little weight if the issue is whether Pan Ocean was a shareholder for purposes of section 220. Nor does the legal opinion of Rainbow's lawyer, Mason, (PX4) that Pan Ocean owns 30% of Rainbow go far to establish that the IRAP was not a "shareholder"; Mason was focusing on ownership interests among the economic interests involved in the venture, of which the IRAP/ Pan Ocean was one, not on the question whether it was the IRAP *or* Pan Ocean which was "the stockholder."

The Shareholder Agreement (PX1) that is signed by each of the investor interests, however, does seem to me a document of some formality and deserving of substantial weight on this question. It,

too, identified interests among investor groups, but the IRAP, who had the authority to cause its interest to be held by its subsidiary, did act in that important instance as if it had done so and all other shareholders acknowledged that fact by entering an agreement with Pan Ocean as a stockholder of Rainbow.

More important, however, to my analysis than the question how actors variously referred to the IRAP/Pan Ocean interest in Rainbow, are two uncontested facts. First of these is the fact that Pan Ocean *is* wholly owned by the IRAP and the second is the admission by Rainbow that the IRAP is a stockholder of Rainbow. Thus, (putting aside for the moment questions concerning the alleged pledge by Tower Capital Corp. of the IRAP/Pan Ocean shares and the later alleged foreclosure on that collateral) Rainbow admits that the IRAP, at any rate, possessed the rights of a stockholder. Its contention here is, thus, the technical one: that the wrong party made the demand to inspect its books and records. It is urged that the wholly-owned IRAP subsidiary was not the correct party to make that demand, rather, the IRAP itself was (insofar as it is willing to concede that any person might be thought to have any possible rights under section 220 when no person was listed on a stock ledger).

As indicated in the February 18 memorandum opinion in this matter, technicalities may sometimes be very material in a books and records case, because those technical matters (the requirement of an oath, for example, or that the person making demand by a stockholder of record or, if an agent of such a person, that the power of attorney or other writing authorizing the agent to act be submitted) are not simply formalistic, but are functional in each instance. The requirement that a demand be made by or in the name of a record stockholder is designed to provide specific administrative benefits to a corporation faced with such a request. Likewise, the proposition that a demand made by the parent of or a subsidiary of a record shareholder in its own name would be unavailing is supported by similar practical considerations.

[3] But, once the court is forced to inquire into the underlying facts concerning stock ownership because the corporation has maintained no stock ledger as contemplated by sections 219 and 220, there is, in my opinion, little or no continued utility in insisting that a valid demand is one made by a shareholder rather than a wholly-owned subsidiary of the shareholder. The purpose of that distinction—affording ease and certainty to the corporation in evaluating 220 demands—can in no event be served in such circumstances and the distinction therefore loses importance. Accordingly, since Rainbow

contends that the IRAP "owned the disputed interest in Rainbow" and acknowledges that Pan Ocean is wholly owned by the IRAP, I can perceive no reason grounded in practical concerns or equitable considerations to deny to the financial interests represented by the IRAP and Pan Ocean a right to inspect Rainbow's books and records in pursuit of a concededly proper purpose.

In so holding, I do not mean to imply that I find the IRAP to be "the stockholder" for these purposes. I, rather, think that if it were necessary (and sensible) for these purposes and on this record to choose which of the IRAP or Pan Ocean should, to the exclusion of the other, be afforded rights under section 220, the record would point to Pan Ocean. *See* Brown Dep. p. 22; Levy Dep. p. 15; PX1; PX4. However, such a distinction, where there is no stock ledger and where other corporate formalities have been ignored, seems too artificial to offer the soundest basis for decision.

III.

I turn now to Rainbow's contention that the stock owned by the IRAP through Pan Ocean was pledged on October 30, 1985 by Andrew Levy (acting with authority) to secure a $183,000 loan made by Rainbow to Sea-Bridge Express, a wholly-owned subsidiary of Pan Ocean, and that the Rainbow stock securing that loan was foreclosed upon, terminating any stockholder interest that the IRAP or Pan Ocean may have had in Rainbow.

This contention raises a welter of factual issues including whether the $183,000 was a loan or not, whether the claimed security interest was given for consideration, and whether Mr. Levy had authority to grant a security interest in the stock in question at the time he purported to do so. These questions, however, need not be resolved as I conclude that, even assuming resolution of them in favor of Rainbow, the record still shows that no valid security interest in all of the stock owned by the IRAP through Pan Ocean was created and, even if one assumes such an interest came into existence, it was not effectively foreclosed.

[4-5] Legal analysis of this issue begins with the observation that the IRAP/Pan Ocean stock interest in Rainbow was uncertificated as that term is used in Article 8 of the Delaware Uniform Commercial Code,[2] 6 *Del.C.* §8-101 *et seq.* Generally, a certificated

2. The parties have stipulated that the validity of the pledge is to be governed by Delaware law.

security is evidenced by an instrument "issued in bearer or registered form." 6 *Del.C.* §8-102(1)(a)(i). An uncertificated security is a share or other ownership interest in a corporation not evidenced by an instrument, 6 *Del.C.* §8-102(1)(b); it is essentially a book entry on the issuer's stock ledger and transfers of interests, including security interests, in such stock may be effected by registration, 6 *Del.C.* §8-108. A security of a kind or class typically represented by an instrument may, nevertheless, be treated as uncertificated in some instances:

> If a certificated security has been retained by or surrendered to the issuer or its transfer agent for reasons other than registration of transfer, other temporary purpose, payment, exchange or acquisition by the issuer, that security shall be treated as an uncertificated security for purposes of this Article.

6 *Del.C.* §8-102(1)(c). The Pan Ocean/IRAP ownership interest in Rainbow, if it was intended by the issuer to be represented by an instrument, was nevertheless represented by a certificate that was either never issued or was "retained by. . .the issuer." *See supra* pp. 4-6. Thus, that interest must be treated for purposes of Article 8 as an uncertificated security. *See Bankhaus Hermann Lampe KG v. Mercantile Safe Deposit & Trust Co.*, 466 F.Supp. 1133, 1142-44 (S.D.N.Y. 1979).

[6] In addressing the question whether a valid security interest was created, we turn first to the provisions of Article 9 of the Uniform Commercial Code which generally governs the creation, perfection and enforcement of security interest in property. That article broadly applies to "any transaction (regardless of its form) which is intended to create a security interest in personal property. . . including. . .instruments [and] general intangibles. . . ." 6 *Del.C.* §9-102(1)(a). Security interests in securities are not excluded from its terms. *See* 6 *Del.C.* §9-104. Thus, in the first instance, we turn to Article 9 to determine the validity and effectiveness of the claimed security interest.

Section 9-203 governs the formal requisites of a security interest. It provides in part that:

> (1) *Subject to the provisions of. . .Section 8-321 on security interests in securities. .* .a security interest is not enforceable. . .and does not attach unless:
> (a) The collateral is in the possession of the secured party

pursuant to agreement, or *the debtor has signed a security agreement which contains a description of the collateral. . .*;
(b) Value has been given; and
(c) The debtor has rights in the collateral.[3] (emphasis added)

The referenced section, 8-321, provides in part:

(1) A security interest in a security is enforceable and can attach only if it is transferred to the secured party. . .pursuant to a provision of Section 8-313(1).

* * *

(3) A security interest in a security is subject to the provisions of Article 9, but:
(a) No filing is required to perfect the security interest; and
(b) No written security agreement signed by the debtor is necessary. . .except as provided in paragraph (h), (i) or (j) of Section 8-313(1).

Section 8-313(1) determines when a transfer of a security to a purchaser (including security interests in a security) occurs. With respect to uncertificated securities its provisions include the following:

(1) Transfer. . .to a purchaser occurs only:

* * *

(b) At the time the transfer, pledge or release of an uncertificated security is registered to him. . .; [or]

* * *

(h) [At the time written notification of the transfer signed by the debtor (in the case of a newly created security interest) is received by designated persons with responsibilities or rights with respect to the collateral] [or]
(i) With respect to the transfer of a security interest where the transferor has signed a security agreement containing a description of the security, at the time new value is given by the secured party.[4]

[7] Reading these provisions together, it appears clear that, in this instance, involving an uncertificated security in which no reg-

3. Debtor is defined in §9-105(d) and includes, where the debtor of the obligation secured is not the owner of the collateral, the owner of the collateral.
4. Subparagraph (j) has no arguable relevance to this case.

istration of a pledge was made on the issuers books, the purported pledge is not enforceable unless there is a writing signed by the owner of the collateral reasonably identifying the property subject to the lien.[5]

Rainbow claims that the requirement of section 9-203(b) of a writing is satisfied by an October 30, 1985 letter signed by Andrew Levy on the letterhead of Tower Capital Corporation (PX8). That letter forwarded a Promissory Note of Sea-Bridge Express together with an unconditional guaranty of Pan Ocean. It concluded with the following:

> Tower Capital Corporation hereby pledges its stock interest in Rainbow Navigation, Inc. as security for the payment of the aforementioned promissory note.
>
> Sincerely,
> TOWER CAPITAL CORPORATION
> Andrew A. Levy
> President

As of October 30, 1985 Mr. Levy served as president of Pan Ocean as well as each of the Tower entities. Very shortly thereafter he was removed from office as Pan Ocean's president and Tower Asset Management was removed as investment advisor to the IRAP. It is contended that the October 30 writing was back-dated and that Mr. Levy had no authority to execute a security agreement on behalf of IRAP or Pan Ocean at the time the document was actually signed. Assuming that the October 30 document is accurately dated, it nevertheless does not satisfy the requirements of section 9-203(1)(a), in that the document does not contain an adequate "description of the collateral."

[8] The description of collateral in a security agreement should be written with reasonable clarity so that those with an interest in the matter, potential future lenders and reviewing courts, need not hazard a guess as to just what property was intended to be covered. *See* 6 *Del.C.* §9-110; *United States v. First National Bank in Ogallala*, 470 F.2d 944 (8th Cir. 1973). This level of clarity is absent in the October 30 writing. What is a reasonable reader to conclude was intended to be covered by the phrase "Tower Capital Corporation['s]. . .stock interest in Rainbow"? Recall that in mid-July,

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5. If the stock were deemed "certificated," the requirement of Section 9-203(1)(a) would not be satisfied by Rainbow's possession of certificates since, in all events, those certificates are not held "pursuant to agreement."

1984, Mr. Yonge, the recipient of the October 30, 1985 letter, had sent a single 250 share certificate registered to Tower Securities, Inc. to Rainbow's counsel with instructions to re-issue it to Pan Ocean. Recall also that later (as of January 1, 1985) Mr. Levy, the signatory of the October 30 letter, had (along with Mr. Yonge) signed the Shareholders Agreement which "confirmed" that, as of January 1, 1985, the stockholders of Rainbow were HTI Ships, Inc., N. Van Reesema and Pan Ocean, but that thereafter Rainbow had in its possession an unissued certificate for 150 shares inscribed with the name of (but never delivered to) Tower Capital Corporation. In these circumstances, one cannot with any confidence know from the description of the collateral contained in the claimed security agreement what is the body of collateral in which an interest is purportedly created. Even if *parol* testimony were to be considered, I could not conclude that the parties each intended the language used to embrace *all* of the stock owned indirectly by the IRAP. *See* Levy Dep. at 150-55. The description of the covered collateral is fatally obscure.

[9-10] I therefore conclude that Rainbow has not acquired a valid security interest in the Rainbow stock owned by the IRAP through Pan Ocean. Moreover, even assuming that there was such a valid security interest, the record establishes that Rainbow did not take the steps necessary to validly foreclose upon that interest. Specifically, it did not comply with the requirement of section 9-505(2) which requires a secured party "in possession" of collateral to give notice to a debtor of an intention to retain the collateral in satisfaction of the debt in default. While I have earlier indicated the view that Rainbow was not in possession of the collateral "pursuant to an agreement," nevertheless, as the issuer of uncertificated stock, with concomitant power (with or without right) to unilaterally transfer legal title to its stock, the strictures of 9-505(2) must be read to extend to it. The power to transfer legal title, in other words, renders an issuer "in possession" of its own stock for purposes of 9-505(2).

[11] Rainbow does not seem to contest this, but, rather, points to its letter of February 14, 1986 (PX9) as satisfying the notice requirement of 9-505(2). That writing provided in pertinent part:

> If payment [on the Sea-Bridge Note] is not received on or before five days from receipt of this notice, legal action will be taken to collect notes together with accrued interest and costs including action against collateral provided for in letter dated October 30, 1985. . . .

This writing does not give the debtor notice that the secured party "propose[s] to retain the collateral in satisfaction of the obligation." 6 *Del.C.* §9-505(2). It threatens legal action against the collateral, but does not specify what type of action is threatened. I cannot read this communication as serving the function that 9-505(2) intends. At least when the rights of no third party purchaser from a secured party in possession intervene, failure to comply with the requisites of 9-505(2) should be read to preclude the effectiveness of the purported foreclosure. *Fletcher v. Cobuzzi*, 499 F.Supp. 694, 699 (W.D.Pa. 1980); *In re Sports Autos, Inc.*, 6 U.C.C. Rep.Serv. 991; J. White & R. Summers, Uniform Commercial Code §26-8 (2d ed. 1980).

Finally, I have considered and reject Rainbow's argument that no consideration was paid to support the claim of the IRAP through Pan Ocean to the stock in question, its argument of collateral estoppel (the federal court did not attempt to focus upon relative rights of IRAP and Pan Ocean *inter se*) and its vague argument of unclean hands.

For the foregoing reasons, I conclude that Pan Ocean, while not a stockholder of record of Rainbow, nevertheless is, in equity, entitled to be so treated for purposes of section 220. I am satisfied as well that the other elements of a proper section 220 demand have been satisfied in this instance. I will, therefore, direct the parties to confer and attempt to agree on a form of implementing order. Failing such agreement, plaintiff may submit an order on notice.

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## PHILLIPS v. INSITUFORM OF NORTH AMERICA, INC.

No. 9173

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

August 27, 1987

Plaintiffs, receivers of Class B shares of defendant, sought a preliminary injunction to enjoin a proposed merger between defendant and its wholly-owned subsidiary that would recapitalize defendant, along with a declaratory judgment that defendant's directors' actions in amending the corporation's bylaws, in issuing shares of