Sale of Gulf Marine Corporation for Tidewater Stock

In the fall of 1990, Zapata reached an agreement in principle, in effect, to transfer its 34.7% stake in Zapata Gulf Marine Corporation ("Gulf Marine") to Tidewater Industries, Inc., an energy services company, whose common stock is listed on the New York Stock Exchange. Effectuation of that transaction was accomplished in June 1991, when Gulf Marine was merged with and into Tidewater. Zapata received 8.3 million unregistered shares of Tidewater common stock in the merger, representing 15.7% of the total outstanding stock. That interest was worth roughly $125 million at that time.

This transaction presented two complications which had to be addressed through special agreements. The more important of them[3] arose from the fact that Tidewater had in place a stockholders' rights plan with a 15% trigger. Since Zapata was receiving 15.7% of Tidewater's common stock in the merger, it was necessary to amend Tidewater's poison pill to create an exemption for Zapata, insofar as it held only Tidewater stock received in the merger. This was done by amending Tidewater's rights plan to provide that as long as Zapata does not acquire any additional Tidewater stock, directly or indirectly, its ownership of stock acquired in the merger would not trigger the distribution of rights under the plan. This protection does not appear to extend, however, to any affiliates or associates of Zapata, as these terms are defined under the poison pill plan.

Zapata's 1992 Strategic Plan

Following the closing of the Tidewater merger, Zapata management turned to consideration of a strategic plan for the survival of Zapata. An "all hands" meeting was held in September 1991 in Houston for that purpose. The resulting business plan was presented to the Zapata board and adopted by it in October 1991. That was the Zapata 1992 Strategic Review and Business Plan. The plan noted that while Zapata had asset values sufficient to support its debt, it

3. The other complication I refer to arose from the fact that a condition of the merger of Gulf Marine and Tidewater was that Zapata's interest in Tidewater be accounted for by the equity method. Use of the equity accounting method allows Zapata to report earnings instead of losses on its financial statements. To effectuate this, certain other major Tidewater stockholders granted Zapata voting control over an additional 4.3% of Tidewater's common stock.

was generating insufficient cash flow to support required payments on that debt. The plan looked towards the further reduction of debt, the acquisition of income producing businesses in the natural gas services industry and development of Zapata's marine protein (fish) operations. In the language of the 1992 Plan itself, it called for the following steps:

> 1. The liquidation of a significant portion of [Zapata's] investment in Tidewater to pay down existing Senior Creditor Debt.
> 2. The establishment of a new banking relationship to provide new financing . . . to retire Senior Creditor Debt.
> 3. The funding of a future growth strategy through increased cash flow from existing operations, liquidation of non-strategic investments, project financing and issuance of equity.

(Mackin Aff. Ex. 1). The plan also called for the liquidation of non-core assets, such as the interest in Arethusa that Zapata had acquired in connection with the sale of its off-shore platforms.

The restructuring under the 1990 MRA had substantially reduced Zapata's debt burden and the 1991 Gulf Marine merger had enhanced the liquidity of the firm's asset base. The company, continued, however, to have cash-flow challenges. It remained indebted by over $145 million[4] and was committed to make large principal payments each quarter.

1992 Efforts to Implement the Plan

The 1992 business plan contemplates an on-going enterprise in some aspect of the oil and gas business. But the Company's largest asset was a passive ownership stake in another firm. Thus, management from the fall of 1991 was anxious to find operating businesses in the oil and gas or affiliated industries that might prove attractive to them and that might be interested in being acquired. Zapata solicited the assistance of investment banking firms to assist it in

4. By early 1992, the Company's principal assets were (1) its Tidewater common stock; (2) its fish company (Zapata Haynie Corporation, which owned a 47 vessel fleet for Menhaden fishing and processing); (3) Zapata Exploration Company ("Zapex"), a small oil and gas production company which has not conducted exploration for new reserves and, therefore, is a wasting asset; and (4) its interest in Arethusa.

identifying appropriate acquisition candidates. Several possibilities were explored and Zapata generally expressed an interest to pay some part of any consideration in stock. For example, at the time Mr. Glazer made his investment, the Company was pursuing an acquisition of Lantana Corporation, which if it had closed would have involved the issuance of some 28.3 million Zapata shares.

Simultaneously with the search for acquisitions prospects, and related to it, was a search for new sources of financing. Banks, investment advisors, investment banks, and insurance companies were contacted. Most proposals appear to have been centered around the possibility of Zapata issuing a preferred stock or debt instrument convertible into shares of the Tidewater stock owned by Zapata. These efforts may have been hampered by the fact that the Tidewater stock was relatively depressed in value at the time, and Zapata's Tidewater stock was unregistered.[5] Efforts to raise financing were also generally hampered by the fact that Zapata had not located any particular acquisition candidate. Investors willing to invest in unknown deals were not found.

Malcolm Glazer Purchases 40% of Zapata's Stock

As noted, the December 1990 MRA resulted in Zapata's lenders holding 83% of Zapata's stock. Many of these lenders were banks disposed to liquidate this holding. In July 1992, Malcolm Glazer, purchased 49,226,662 shares of Zapata common stock representing 38.8% of Zapata's common stock. All but 500,000 of these shares were purchased in large private transactions. The largest single purchase was of 32 million shares from a single holder on July 16, 1992. Mr. Glazer has since increased his ownership to 40.3%. The 13D plaintiff filed on July 21, 1992, described his purpose:

> [Glazer] is currently evaluating his position concerning [Zapata], although he has no definitive plan at this time . . . [Glazer] may seek to: obtain representation on [Zapata]'s board of directors; change [Zapata]'s present board of directors or management; change the number or term of [Zapata]'s directors; or change [Zapata]'s charter, bylaws . . . or anything else which may impede the [Glazer]'s acquisition or control of [Zapata].

5. While Zapata had registration rights, other holders had the right to "piggyback" on any such registration.

(Glazer Dep. Ex. 10 at 4). Mr. Glazer paid between $0.80 to $0.96 per share.

Mr. Glazer was unknown to senior management at the time of his 13D filing. On July 27, 1992, at the invitation of Ronald Lassiter, chief executive officer of Zapata, Mr. Glazer, together with one of his sons, met with Zapata's senior management in Houston for five or six hours. At that meeting a briefing covering the Company's assets and business plans was presented. The presentation and documents given to the Glazers at that time explained that the Company was considering an acquisition (the Lantana transaction) that would involve the issuance of Zapata common stock and that Mr. Glazer could expect that his proportionate interest in the Company would be diluted from 38.8% to 30.8%, as a result of the closing of that transaction.

On July 28, 1992, John P. Laborde, the CEO of Tidewater, sent a letter to the members of his board. In that letter Mr. Laborde expressed concern about Glazer accumulating Zapata stock. As a result of the Tidewater-Gulf Marine merger, the three former owners of Gulf Marine (Zapata, Corporate Partners and Bessemer Capital Partners) together hold 40% of Tidewater stock and Zapata appears to control the vote of half of that stock. Any CEO would be very interested, and appropriately so, in the implications for his or her company of any prospect of a change in control of such a shareholder. In his letter to the Tidewater board, Laborde stated that were Glazer to purchase more than 50% of Zapata's common stock, Zapata could be considered Glazer's affiliate. It was suggested that the "carve out" for Zapata's 15.7% ownership in Tidewater's shareholders' rights plan would not apply to Glazer as the indirect owner of 15.7% through Zapata. On August 5, 1992, an attorney from Tidewater sent a letter to Lassiter stating that "on the basis of Mr. Glazer's SEC filings, Tidewater is concerned that he is treading very close to the line under Tidewater's Rights Agreement [poison pill]." (Glazer Dep. Ex. 6).

Zapata management viewed the threat of the Tidewater pill as an impediment to any further action by Glazer. The minutes of Zapata's August 13, 1992 board of director's meeting state that:

> [T]he Chairman advised that the provisions of the Tidewater Rights Agreement would apparently preserve the status quo for some period of time, since any additional purchases by Mr. Glazer, or his being accorded one or more seats on the Board of Directors might be deemed to constitute control

> of the Company, and thus a triggering event under that Agreement.

(Mackin Dep. Ex. 6 at 5).[6]

Following the August 13 meeting, Lassiter and John Mackin, a former CEO and present director of Zapata, traveled to New Orleans to meet with Mr. Laborde and other members of Tidewater management. There is testimony that at the meeting, Mr. Mackin took the position that the pill had not yet been triggered, but that Laborde would not commit to any position on that subject.

Standstill Agreement Negotiations

Throughout the period August 1992 through November 1992, Zapata, Tidewater and Glazer engaged in a series of negotiations looking towards a standstill agreement. From Tidewater's perspective this involved raising the spectre of a present or future declaration by it that Glazer's acquisition of Zapata shares, or his nomination of one or more Zapata directors, constituted a triggering event. It sought as much protection as it could get from the prospect of Mr. Glazer gaining influence over it or control over its important stockholder. From Zapata's position it of course wanted agreement that no triggering event had occurred and wished to assure that none would. But more importantly, it is obvious that the board sought as well to deploy the *in terrorem* effect of the Tidewater pill as a way to discourage Glazer from seeking, or receiving the support necessary to achieve, the proportionate board representation that he sought. From Glazer's point of view an agreement with Tidewater was one way to defuse the risk that the Tidewater pill posed to his acquisition of further Zapata stock or to his gathering of election support from other shareholders.

Those negotiations are complex and do not relate directly to the Norex transaction. The Norex transaction arises as a possibility in January and was negotiated in February, after Glazer's effort to negotiate an agreement with Tidewater failed. Tidewater and Zapata

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6. According to the testimony of Mr. Sinders, an investment banker with Jefferies & Co., Zapata management informed him at the time that Glazer purchased his Zapata shares, that because of the Glazer's investment, Zapata would not pursue any transactions which involved reducing Zapata's stake in Tidewater below the 15% level at which the Tidewater pill would be triggered. (Sinders Dep. at 68). That assertion is denied.

did reach an agreement in November 1992. That agreement committed Tidewater to amend its rights plan to provide that Glazer's acquisition of 51,976,923 shares of Zapata is not "a Trigger Event under the Rights Agreement" and committed Tidewater not to thereafter "make any public announcement that Glazer has become an Acquiring Person" so long as Mr. Glazer refrains from a long list of things relating to the corporate governance of Zapata, including seeking to elect or nominating more than one director of the Company or seeking to remove any current Zapata director. Glazer, however, was not a party to that agreement.

Continued Effort to Implement Business Plan

The effort to implement the business plan appears to have continued through this period. The Lantana deal which was alive in July, was abandoned in August. In the fall a possible acquisition of Holt Companies Energy Group, Inc. ("Holt") became the subject of conversations and negotiations. Holt is a company engaged in the marketing of natural gas compressors for use in field compression of natural gas. Mr. Lassiter testifies that an oral agreement in principle was reached with Holt in January 1993. The deal called for cash and Zapata stock.

Also in January 1993, Lassiter met with Mr. Kristian Siem, a principal of Norex. Norex had been a holder of Zapata stock and debt since 1990. The Siem and Lassiter meeting had been a usual occurrence once or twice a year since Norex had acquired its interest. According to Lassiter, he told Siem at that 1993 meeting that he was considering a refinancing of Zapata and an acquisition of Holt, but that he was having difficulty securing financing. According to his own testimony, Siem then stated that Norex had a substantial amount of cash available and it would consider financing the Holt transaction.

In early February Glazer filed an amended Schedule 13D stating that he presently intended to nominate a slate of three directors to fill the three vacancies that would be elected in Zapata's staggered board at the 1993 annual meeting, which could be expected to be held in June.

On February 19, 1993, Lassiter and other Zapata representatives traveled to France to meet with Norex representatives. After two days of negotiations, the basic terms of a transaction were reached. On March 4, 1993, Norex and Zapata signed a commitment letter. Under the final Norex Agreement, Zapata is to sell to Norex the

following: (1) $50,000,000 principal amount of Secured Notes, bearing 13% interest and maturing in three years; (2) $32,625,000 principal amount of Senior Convertible Notes also bearing 13% interest and maturing in three years; (3) 17,500,000 shares of Preferred Stock for $1.00 per share, bearing an 8.5% dividend and convertible into 1 share of Tidewater common stock for 26 preferred shares; (4) 15 million shares of Zapata common stock for $0.75 per share. To secure repayment of the notes, Norex will have a first lien on all property of Zapata. The transaction, however, contemplates the sale of 3,458,220 of Zapata's Tidewater shares for the purpose of consummating the Holt transaction which is tentatively scheduled to close on June 30, 1993.

A week after the Norex commitment was signed, Zapata signed a commitment letter with Holt. That letter contemplated a price of $74 million cash and up to 13.5 million Zapata shares. A final contract has not yet been signed.

Consideration of the Norex Transaction

The proposed Norex transaction was presented to the board at a special meeting on March 26, 1993. The presentation included management's opinion that it would be very difficult to obtain an alternative transaction and that the previous search for financing demonstrated that traditional commercial lenders were not interested in investing in Zapata in its present circumstances. Simmons & Company ("Simmons"), an investment banking firm specializing in the oil and gas industry, had been retained to provide an opinion on the fairness of the Norex transaction. Simmons' fee for this fairness opinion is contingent upon the transaction closing. Thus, it is not disinterested in the board's decision.

On April 13, 1993, the Zapata board met again and after considering the Norex transaction, the Holt acquisition, and the Simmons opinion that the transaction was fair, voted to approve the Norex transaction.

Glazer Proposes an Alternative Refinancing Transaction

After he learned of the Norex transaction on April 16, 1993, Mr. Glazer retained Jefferies & Company, an investment banking firm, and requested that Jefferies formulate an alternative proposal for the financing of Zapata. Jefferies valued the package of securities to be sold to Norex for $111.4 million as having a market value of

$125.6 to $133.7 million. It suggested as an alternative the issuance of: (1) $75 million in Senior Secured debt bearing interest at a range of 9.75 to 10.25% and having an average maturity of 8.5 years; (2) Preferred Stock paying dividends of between 6.75% and 7.25%, convertible to one share of Tidewater stock for each 27.06 preferred shares; and (3) 15 million shares of common stock for $1.00 per share or $15 million. The debt and preferred stock would be sold in public offerings, while the common stock would be purchased by Glazer (although an offering of pre-emptive rights to existing shareholders would apparently be acceptable to plaintiff).

The refinancing package proposed by Jefferies would, if achievable, initially at least, be significantly less expensive than the Norex transaction. The debt which Jefferies proposes to sell in a public offering has a lower interest rate and longer maturity than the debt Norex proposes to buy. The preferred stock Jefferies proposes to have Zapata issue in a public offering has a lower dividend rate and is convertible into slightly fewer Tidewater shares, than the preferred stock to be sold to Norex. Finally, Jefferies proposes that Zapata sell to the Glazers the same number of common shares that Norex plans to purchase, but at $1.00 per share (in total, $3.75 million more) instead of the $0.75 per share Norex would pay.

The Jefferies proposal is not the strict equivalent of the Norex transaction and has several disadvantages: (1) the Jefferies proposal contemplates the sale of Zapata debt and preferred stock securities in a public offering, the feasibility of which is unclear if not doubtful; (2) it is unclear whether a public offering could be concluded quickly enough to close the Holt transaction as scheduled on June 30, 1993; (3) sale of the 15 million common stock shares to Glazer would involve granting him a controlling or very near controlling block of Zapata's stock; (4) more importantly, the Norex transaction is a fully committed deal, while the Jefferies alternative is a proposal for which Jefferies was unable to give a "high confident" letter, let alone a form of assurance against which the Company might have legal recourse.

On April 30, 1993, one day after Glazer filed this action, the Zapata board met to consider the relative merits of the Norex and Jefferies transactions. The board decided to continue to pursue the Norex transaction.

II.

[1-2] It is thoroughly established that in order to prevail on a motion for a preliminary injunction:

> the plaintiff must demonstrate a reasonable probability of success on the merits and that irreparable harm will occur absent the injunction. Additionally the plaintiff must show that the harm it would suffer absent an injunction outweighs the harm to the defendant if relief is granted.

Allen v. Prime Computer, Inc., Del. Supr., 540 A.2d 417, 419 (1988); *Ivanhoe Partners v. Newmont Mining Corp.*, Del. Supr., 535 A.2d 1334, 1341 (1987). In this instance I cannot conclude that there exists a reasonable probability of success on plaintiff's claim that the Norex transaction is intended primarily to impede or affect a forthcoming election contest or is otherwise wrongful.

III.

The Norex transaction is attacked on two bases primarily. First it is said to be a bad deal; the price paid both in terms of interest and equity dilution is said to be substantially more than alternative market transactions would offer. Plaintiff has offered affidavit testimony to support this view. The alleged generousness of the terms of the financing (from Norex's point of view) is said by plaintiff to have another and greater significance relating to the second argument in favor of the injunction sought. The second basis is that the Norex transaction (and most pointedly the inclusion of a present equity component in it) was designed primarily for an inequitable purpose: the dilution of Mr. Glazer's voting power in the face of his challenge to the incumbent directors.

A.

[3] As to the first theory, that the transaction is wasteful, the legal test is severe. Directors are guilty of corporate waste, only when they authorize an exchange that is so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration. If reasonable, informed minds might disagree on the question, then in order to preserve the wide domain over which knowledgeable business judgment may safely act, a reviewing court will not attempt to itself evaluate the wisdom of the bargain or the adequacy of the consideration. *See Grobow v. Perot*, Del. Supr., 539 A.2d 180, 189 (1988); *Saxe v. Brady*, Del. Ch., 184 A.2d 602 (1962). It is not likely that this test will be satisfied in this case on a final hearing.

[4] It is significant that Zapata has been unable to find a lender willing to extend substantial new credit to it nor has it been able

to arrange a mutually agreeable stock acquisition of a substantial enterprise. The views of Jefferies & Co. might prove correct in time or they may prove to be unduly optimistic. Jefferies has not committed in a way that would give assurance that it could put a cheaper equivalent package of financing in place. Thus, the court is left with a difference in business judgment.

B.

The alleged inadequacy of the terms of the Norex contract are said by plaintiff to have another significance (beyond that of a waste claim). Those terms evidence the fact, it is said, that the defendants are not primarily interested in achieving the best, most economical debt restructuring for Zapata, but are primarily motivated to place voting securities into friendly hands in order to dilute Mr. Glazer's voting power and preserve their own endangered offices. Thus, plaintiff asserts that the board's judgment is entitled to no deference because the Norex transaction is a defensive response to Mr. Glazer's acquisition of a 40% block of Zapata stock and his announced intention to possibly seek to elect three directors.

[5-6] Mr. Glazer asserts that this transaction is defensive; it protects the incumbent directors in office and must satisfy the test announced in *Unocal Corp. v. Mesa Petroleum Co.*, Del. Supr., 493 A.2d 946 (1985). Thus, he says the board must demonstrate that Glazer's acquisition of stock and intention to possibly run a slate of directors at the next annual meeting constitutes a threat to the corporation and that its dilution of his voting power is a reasonable response to that threat in the circumstances. But plaintiff asserts that defendants can make no such showing because the prospect of a stockholder exercising the proportionate power to elect directors that the certificate of incorporation confers upon him cannot constitute a legally cognizable threat to the corporation. *See Blasius Industries, Inc. v. Atlas Corp.*, Del. Ch., 564 A.2d 651 (1988). Thus, plaintiff says the Norex transaction cannot meet the modified business judgment test of *Unocal* and must be seen as an inequitable deployment of directorial power.

[7] For purposes of this preliminary injunction application, I cannot accept that the Norex transaction should be reviewed under the *Unocal* test. That is, I do not accept at this stage that that transaction is motivated solely, primarily or even substantially as a defensive transaction. A preliminary assessment of the record suggests that the Norex transaction is an important step in realizing the business plan that the board had developed prior to Mr. Glazer's arrival on the scene.

[8-9] In part, the terms of the transaction itself are supportive of that tentative conclusion. They do not tend to suggest that a third party (Norex) has been specially accommodated in order to employ that party as a secure, management-controlled source of voting power. *Compare Shamrock Holdings v. Polaroid*, Del. Ch., No. 10,582, Berger, V.C. (Jan. 31, 1989) [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,340, at 92,217 (agreement substantially limiting exercise of vote-related rights of holder of preferred). Most importantly neither the incumbent Zapata directors nor the corporation itself will in any respect control how the new stock is voted; nor does Norex covenant not to vote against incumbents or proposals they endorse, or not to run a proxy contest or be part of a group for that purpose.[7] Thus, in every formal way the shares to be issued to Norex will be as free as are any public shares to vote in whatever way the holder believes will be most likely to increase the net value of his or her investment in Zapata.

[10] Nor does the record give grounds to suspect that the issuance of this stock will be entrenching because of social facts that may run deeper (and be less observable than) formal legal rights and duties. The record, at this stage is most suggestive of an entirely appropriate and open relationship between Mr. Siem, a principal in Norex, and Mr. Lassiter. Siem has a long but shallow business acquaintance with Lassiter. He caused Norex to become a shareholder and debt holder of Zapata in 1990. When he then sought membership on the Zapata board he was twice rebuffed. Thus, there appears to be no grounds to see Norex as an accommodation party whose vote as a stockholder will be affected by anything other than its economic interest as a creditor and owner.

[11] That the transaction when accomplished will dilute the voting power of Mr. Glazer is not legally significant on the facts as they appear at this stage. The cases in which this court has found the issuance of shares that dilute control as constituting a violation of an equitable duty are distinguishable from this case as it now appears: *Condec Corp. v. Lunkenheimer Co.*, Del. Ch., 230 A.2d 769 (1967); *Canadian S. Oils, Ltd. v. Manabi Exploration Co.*, Del. Ch., 96 A.2d 810 (1953); and *Packer v. Yampol*, Del. Ch., No. 8432, Jacobs, V.C. (Apr. 18, 1986). Plaintiff argues that these cases "demonstrate [that]

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7. *Cf. Abajian v. Kennedy*, Del. Ch., No. 11,425, Allen, C. (Jan. 17, 1992) (restriction on voting rights of preferred provide ground to excuse demand under Rule 23.1); *Good v. Texas*, 1984 WL 8220 (Del. Ch.).

this court will not sustain a stock issuance, even one with a purported business justification, if it finds that the issuance will perpetuate the incumbent directors' control." (Plaintiff's Br. at 58-59).

[12] On this record it is entirely unclear how long the incumbent board will be "perpetuated" in office if the Norex (and Holt) transactions are accomplished. It rather depends, one supposes, on the Company's financial performance in the not too distant future. But putting that speculation aside and assuming with plaintiff that closing of the Norex transaction will have the effect of "perpetuating" control in the incumbents at least for a period, nevertheless such an *effect* does not itself provide a ground to invalidate board action; rather it is the purpose that motivates the board to take action having that effect that is critical.

In *Condec*, the Lunkenheimer Company, rejected Condec's offer of a merger, and when Condec then sought to begin acquiring its shares, Lunkenheimer entered into a contract for the sale of substantially all of its assets to Textron, Inc. Condec responded by extending a tender offer for 51% of Lunkenheimer's common stock which it closed before the shareholders' meeting could be held to vote on the Textron sale. The day of the stockholders' meeting Lunkenheimer entered a second asset sale agreement, this one with U.S. Industries ("USI"). The prior day it had entered a stock purchase agreement pursuant to which it issued 75,000 shares of Lunkenheimer stock to USI in return for preferred stock of USI. USI sought to vote its Lunkenheimer stock in favor of the asset sale. Condec sought to enjoin that vote.

The court rejected Lunkenheimer's claim that it had issued the common stock in order to preserve Lunkenheimer's corporate existence for tax purposes. The court stated:

> In view of the haste with which the basic Lunkenheimer-U.S. Industries transaction was hammered out . . . followed up by a decision to have Lunkenheimer issue 75,000 new shares, when a substantially smaller number would have served the purpose of preserving Lunkenheimer as a corporate entity, *I have reached the conclusion that the primary purpose of the issuance of such shares was to prevent control of Lunkenheimer from passing to Condec and to cause such control to pass into the hands of U.S. Industries.*

Condec, 230 A.2d at 775 (emphasis added). The court ordered that the 75,000 shares issued be canceled explaining that:

> the transaction here attacked . . . was clearly unwarranted because it unjustifiably strikes at the very heart of corporate representation by causing a stockholder with an equitable right to a majority of corporate stock to have his right to a proportionate voice and influence in corporate affairs to be diminished by the simple act of an *exchange of stock which brought no money into the Lunkenheimer treasury . . . and which was obviously designed for the primary purpose of reducing Condec's stock holdings in Lunkenheimer below a majority.*

Id. at 777 (emphasis added).

Canadian Southern Oils involved a dispute between the president and large minority stockholder of Manabi Exploration Co., a Mr. Hagan, and Manabi's majority stockholders, the "Buckley interests," regarding the proper resolution of Manabi's financial difficulties.

Hagan sent a telegram to the Buckley representatives in New York on March 23, 1953, calling a board meeting of the Manabi Company on March 27 in Houston, Texas. Hagan rejected requests for a few days delay. The meeting was attended exclusively by directors sympathetic to Hagan. The board voted to issue 226,950 shares of Manabi common stock, 26,950 of which were sold to the attending board members and 200,000 of which were sold through an underwriter primarily to two large buyers. On the record it was reasonable to infer that Hagan had arranged the purchase of the shares before he called the board meeting.

Hagan claimed that the shares were issued to raise money "to meet defendant's dire financial plight" but conceded that "if the primary purpose of the sale was to deprive plaintiff of its voting position then the action was improper." *Id.* at 813. The court considered the circumstances surrounding the issuance of the shares and held that:

> when the undisputed facts are viewed cumulatively I find it reasonable to infer that the primary purpose behind the sale of these shares was to deprive plaintiff of the majority voting control. Hagan and his associates did too much too soon with too little disclosure to justify a contrary conclusion.

Canadian S. Oils, 96 A.2d at 813. The Chancellor granted a preliminary injunction against the issuance, transfer and voting of the shares.

In *Packer v. Yampol*, management sought to defeat a proxy contest launched by outside investors by issuing to the founder and president,

Mr. Yampol and to entities allied with Yampol, super-voting preferred stock, which held 33% of the total voting power of the company. The issuance of the preferred stock gave Yampol control of 44% of the voting power of the company. The super-voting preferred was also given a right to veto major transactions such as mergers and asset sales. The defendants paid only $0.86 per vote at a time when the common stock was selling for $8.75 per share. *Packer*, No. 8432, slip op. at 22-23. This court rejected defendants' claims that the preferred stock was issued to Yampol and his allies because the company needed to raise capital and they were the only interested investors. The court held that "[w]hile raising capital may have been a purpose for the directors' conduct *their primary purpose was to obstruct plaintiffs' ability to wage a meaningful proxy contest in order to maintain themselves in control . . . .*" *Id.* at 39 (emphasis added). A preliminary injunction against the voting of the preferred shares was issued.

[13-14] These cases stand for the proposition that directors may not act to frustrate the efforts of stockholders to elect new directors by engaging in transactions that are designed and pursued for the primary purpose of diluting the votes held by the insurgent stockholders. As such they are articulations of the principle which was old and well established when articulated in *Schnell v. Chris-Craft Industries*, Del. Supr., 285 A.2d 437 (1971), that "the subversion of corporate democracy by manipulation of corporate machinery will not be countenanced under Delaware law." *Moran v. Household Int'l, Inc.*, Del. Ch., 490 A.2d 1059, 1080 (1985). *See also Blasius, supra*; *Aprahamian v. HBO & Co.*, Del. Ch., 531 A.2d 1204 (1987).

[15-16] That principle does not, however, require that management refrain from issuing voting securities, and thereby diluting the voting strength of insurgent stockholders, during the pendency of a proxy context, when the issuance legitimately has a primary purpose directed to the management of the corporation and its businesses. Thus, like most equity cases, resolution of issues of this sort are typically highly particularized—factual. The Norex transaction, unlike the stock issuances enjoined in the above cases, is the outgrowth of a long-term plan pursued by management for more than a year, of obtaining new capital for Zapata. Its terms are supportive of that purpose, not of a masked corporate control purpose. The record does not support the conclusion at this time that the sole or primary purpose of the Norex transaction is to dilute Glazer's stake in Zapata and thereby defeat his efforts to elect three nominees to the Zapata board. Therefore, Glazer's request for a preliminary injunction pro-

hibiting the consummation of the Norex transaction will be denied.

HOLDGREIWE v. NOSTALGIA NETWORK, INC.

No. 12,914

Court of Chancery of the State of Delaware, New Castle

April 29, 1993

Plaintiff, a director of the defendant, a Delaware corporation, brought an action to require defendant to allow him to inspect the corporate books and records pursuant to Delaware Code Annotated, title 8, section 220(d). Plaintiff, acting in his capacity as a director, sought to inspect the company's books and records as part of an investigation into the company's finances which he believed to be relevant to allegations of wrongdoing and which impacted upon a pending stock transfer transaction with another corporation. The defendant's CEO and chairman refused plaintiff's demand.

The court of chancery, per Chancellor Allen, held that plaintiff's demand, which requested detailed financial data, stock transfer books, tax information, intra-corporate communications, correspondence regarding personal investment in defendant by third parties, press releases, and communications and filings with securities regulators, was to be honored fully and completely. While directors of Delaware corporations have the right to inspect corporate books and records under section 220(d), this right of inspection is not absolute. The burden of proving that the director does not have a proper purpose for the requested inspection rests upon the corporation. The court found that defendant corporation failed to meet this burden and ordered it to comply with plaintiff's demand.

1. Corporations ⟹311, 321

A director of a Delaware corporation is entitled to inspect the corporate books and records for a purpose reasonably related to his position as a director, and to enforce this right through a summary proceeding in court. DEL. CODE ANN. tit. 8, § 220(d) (repl. vol. 1991).

2. Corporations ⟹ 307, 311

The rights of directors to access the corporate books and records are recognized by Delaware law as of fundamental importance and a necessary concomitant to the imposition upon directors of fiduciary duties.

3. Corporations ⟹ 311

The rights of inspection are not absolute. If the corporation bears its burden of proving that the director does not have a proper purpose for the requested inspection, inspection will be denied.

4. Corporations ⟹ 310(1), 311

Obtaining information concerning allegations of mismanagement of the corporation by management's alleged misappropriation of funds is a proper purpose for which a director may request an inspection of the corporate books and records as it comports with a director's primary duty to take steps to protect corporate assets from dissipation through misconduct.

5. Corporations ⟹ 311

Where allegations of an ulterior purpose for the director's request to inspect corporate records have been made, the critical inquiry is whether the stockholder related purpose predominates over the ulterior purpose.

6. Corporations ⟹ 311

Although an ulterior purpose may be unproven, a director's inspection of corporate books and records will be subject to appropriate limitations requested by the defendant and designed to minimize the risk that any information obtained by the director will be misused to interfere with ongoing negotiations unrelated to the director's stated purpose.

7. Corporations ⟹ 307, 311

In the absence of evidence that directors are breaching their fiduciary duties to the corporation, the court cannot strip them of

their rights, as directors, to full information concerning the corporation's affairs.

8. Corporations ⟹ 310(1), 311

Where management wrongdoing is being investigated, the scope of a director's inspection cannot be materially limited by being subject to restrictions imposed by management. Where a director's inspection of a corporation's records is to effectuate its purpose of enabling him to determine whether management wrongdoing has occurred, his access to the corporation's records must necessarily be broad and unrestricted.

Thomas P. Preston, Esquire, and John L. Olsen, Esquire, of Duane, Morris & Heckscher, Wilmington, Delaware, for plaintiff.

Stephen E. Jenkins, Esquire, of Ashby & Geddes, Wilmington, Delaware; and Merrick Scott Rayle, Esquire, of Crane, Rayle & Lennemann, Santa Monica, California, of counsel, for defendant.

ALLEN, *Chancellor*

This is an action brought by Daniel C. Holdgreiwe, a director of Nostalgia Network, Inc., a Delaware corporation, ("Nostalgia"), to require Nostalgia to allow him to inspect its corporate books and records, pursuant to 8 *Del. C.* § 220(d). Plaintiff demanded access to the corporate books and records by sending a letter to Michael Marcovsky, Nostalgia's chairman and chief executive officer, on March 18, 1993. This demand was rejected by Nostalgia's counsel in a letter dated March 23, 1993. Plaintiff filed suit on March 26, 1993, and after expedited discovery, a trial was held on April 27, 1993. This is the court's decision after trial.

I.

This litigation is part of a broader dispute between the two companies that share control of Nostalgia, Gold 'N M Television ("GNM"), which owns 22% of Nostalgia's stock and Concept Communications, Inc. ("Concept"), which own 26%. GNM, which is wholly owned by Mr. Marcovsky, and Concept are parties to a Shareholders Agreement and a Vote Pooling Agreement through which GNM elects five of Nostalgia's ten directors and Concept

elects the other five. *See Concept Communications, Inc. v. Gold 'N M Television, Inc.*, Del. Ch., No. 12,816, Allen, C. (Apr. 28, 1993). Plaintiff is a nominee of Concept to the Nostalgia board.

GNM and Concept are now involved in a struggle for control of Nostalgia. A buy/sell agreement, which is an element of the Shareholders Agreement, has been triggered by GNM. GNM has triggered its right under the terms of the agreement and has set a price for its stock ($3 per share) at which Concept must either sell all of its Nostalgia stock to GNM or buy all of GNM's shares.

Control of the Nostalgia's ten-person board of directors has been equally divided between GNM and Concept since 1991 when GNM sold one half of its then 52% stake in Nostalgia to Concept. Marcovsky, however, remained in control of Nostalgia's management as CEO and chairman. Under Marcovsky's management, Nostalgia has entered into contracts with affiliates of GNM and Concept, including Concept's affiliate, Atlantic Video, Inc. ("AVI"). Relations between Concept and GNM appear to have been amicable until, Concept's parent, Crown Communications, Inc., removed Mr. Jonathan Park as CEO of Concept and replaced him with Mr. Dong Moon Joo, in early October 1992. Mr. Joo also replaced Mr. Park as president of AVI and as a director of Nostalgia. Mr. Joo designated plaintiff Holdgreiwe for the Nostalgia board at this time.

One source of friction between the Concept nominees and GNM was the discovery in the summer of 1992, of facts suggesting that Mr. Michael E. Kassan, a former Nostalgia director, of counsel to Nostalgia's law firm, and a friend of Marcovsky, had embezzled $1 million from Nostalgia. While Concept's nominees initially sought an investigation by the entire board of Mr. Kassan's alleged wrongdoing, Marcovsky successfully argued for the appointment of a special committee of the board consisting of two outside directors.[1] To date the special committee has yet to issue a report of its findings with respect to the Kassan matter, although it has shared a report prepared by Nostalgia's regular counsel with the Nostalgia board.

In the fall of 1992, plaintiff, in his capacity as a board member, received reports that Mr. Marcovsky had allegedly received improper

1. While Concept and GNM each nominate five board members, one nominee of each must be approved by the other and is required to have no financial interest in either GNM or Concept. The special committee members are William A. Jones, Esquire, vice president, general counsel & secretary of Metro-Goldwyn Mayer, Inc. and former-Ambassador Gerald Carmen.

payments from Nostalgia. Mr. Gary Winnick, the chairman of Tiger Communications, Inc., a four percent shareholder of Nostalgia, sent a letter to the Nostalgia board alleging that Marcovsky had improperly received funds from Nostalgia. Winnick threatened to file a derivative lawsuit if the board failed to act. After these charges were made, the Concept-nominated directors of Nostalgia attempted to call a board meeting, but were unsuccessful as none of the GNM nominated board members attended the meeting and a quorum, therefore, could not be obtained.

In December 1992, Concept initiated suit in this court claiming that a transaction between GNM and another corporation, Allied Cellular Systems, Inc., constitutes a transfer of beneficial ownership of Nostalgia shares thus triggering its rights of first refusal under the Shareholders Agreement.

On March 2, 1993, GNM invoked its rights under the buy/sell provision of the Shareholders Agreement. On March 10, 1993, a meeting by GNM of the Nostalgia board was held at which Holdgreiwe requested access to certain documents which he believed to be relevant to the allegations against Mr. Marcovsky. Marcovsky agreed to provide the documents but has yet to do so.

On March 18, 1993, Holdgreiwe sent a letter to Marcovsky demanding that, in his capacity as director of the company, he be allowed to inspect the company's books and records. The purpose that can be distilled from that letter was an investigation into the company's finances, especially because of the planned filing of a S.E.C. Form 10-K. Holdgreiwe testified that he had grounds (identified in testimony) to worry that the proposed filing was not correct. The demand letter stated that Holdgreiwe sought documents:

> With regard to the conduct of the Company's affairs by the Company's management and with regard to disclosures to be included in Federal securities filings to be made by the Company including the Form 10-K to be filed by the Company for its fiscal year ended December 31, 1992 and a proxy statement with respect to the 1993 annual meeting of stockholders.

(Px. 18). Nostalgia rejected Holdgreiwe's demand stating that it was not required to comply because: (1) Holdgreiwe intended to use the inspection to obtain information to assist Concept in ongoing litigation with GNM concerning the Shareholders Agreement; (2) Holdgreiwe was seeking to circumvent limits on Nostalgia's disclosure obligations concerning the buy/sell agreement; and (3) Holdgreiwe was seeking

information from Nostalgia regarding a contract for studio services between it and AVI. *See* Px. 24. Nostalgia claimed that Holdgreiwe does not have a purpose for the requested inspection which is reasonably related to his position as a director.

On April 5, 1993, Concept demanded substantially the same information as a stockholder, in order to allow Concept to value its stock to decide whether to be a buyer or seller under the buy/sell agreement. *See* Px. 19. This letter was signed by Holdgreiwe in his capacity as vice president of Concept. Nostalgia has agreed to provide information relevant to this valuation, but continues to resist Holdgreiwe's demand.

II.

[1] A director of a Delaware corporation is entitled to inspect the corporate books and records for a purpose reasonably related to her position as a director, and to enforce this right through a summary proceeding in this court. Section 220(d) of title 8 of the Delaware code provides as follows:

> Any director shall have the right to examine the corporation's stock ledger, a list of its stockholders and its other books and records for a purpose reasonably related to his position as a director. The Court of Chancery is hereby vested with the exclusive jurisdiction to determine whether a director is entitled to the inspection sought. The court may summarily order the corporation to permit the director to inspect any and all books and records, the stock ledger, and the stock list, and to make copies or extracts therefore. The court may in its discretion, prescribe any limitations or conditions with reference to the inspection, or award such other and further relief as the court may deem just and proper.

8 *Del. C.* § 220(d).

[2] The rights of directors to access to the corporate books and records are recognized by Delaware law as of fundamental importance and a necessary concomitant to the imposition upon directors of fiduciary duties. As this court stated in *Henshaw v. American Cement Corp.*, Del. Ch., 252 A.2d 125, 128-29 (1969):

> A director of a Delaware corporation has the right to inspect corporate books and records; that right is correlative with his duty to protect and preserve the corporation. He is a

> fiduciary and in order to meet his obligation as such he must have access to the books and records; indeed he often has a duty to consult them. *Hence, he makes out a prima facie case when he shows that he is a director, he has demanded inspection and his demand has been refused. The burden then shifts to the corporation to show why the director should not be permitted to exercise his rights* or that such exercise should be conditional. (emphasis added)

[3] These rights of inspection are not absolute, however. If the corporation bears its burden of proving that the director does not have a proper purpose for the requested inspection, inspection will be denied. In *State ex rel. Farber v. Seiberling Rubber Co.*, Del. Super., 168 A.2d 310 (1961), for example, the court noted that:

> a director's right to inspect corporate books . . . may be termed an absolute right only so long as his purpose is not in derogation to the interest of the Corporation. However, if it can be established that his motives are improper, or that they are in derogation to the interest of the corporation, then his right to inspect ceases to exist.

Id. at 312. *See also Carpenter v. Texas Air Corp.*, Del. Ch., No. 7976, Hartnett, V.C. (Apr. 18, 1985).

In the present case, it is undisputed that Holdgreiwe is a director, that he has demanded inspection and that the demand has been refused. Therefore, the sole issue remaining to be resolved is the question of whether Nostalgia has succeeded in bearing its burden of showing that Holdgreiwe's primary purpose of seeking this inspection is improper, i.e., any purpose not related to his position as a director. For the reasons that follow, I am required to conclude that Nostalgia has not done so.

III.

Defendant argues that Holdgreiwe has failed to articulate any purpose reasonably related to his position as a director for the inspection he seeks and that the real reasons for his request are the improper goals of: (1) providing valuation information to Concept for use in connection with its decision on whether to buy or sell under the buy/sell agreement; and (2) aiding Atlantic Video (AVI) in its dispute regarding contracts it has with Nostalgia.[2]

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2. In its letter rejecting Holdgreiwe's demand for inspection, Nostalgia also

[4] In both his demand letter and his testimony at trial, Holdgreiwe stated that his purpose in requesting an inspection of Nostalgia's records is to obtain information concerning the question whether Nostalgia's management, particularly Mr. Marcovsky, had mismanaged the company by misappropriating its funds. This is a proper purpose for which a director may request an inspection of the corporate books and records. *E.g.*, *Nodana Petroleum Corp. v. State ex rel. Brennan*, Del. Supr., 123 A.2d 243 (1956). One of a director's primary duties is to take steps to protect corporate assets from dissipation through misconduct.

Holdgreiwe has reason to suspect that Marcovsky may have engaged in some wrongdoing. The alleged Kassan embezzlement and the allegations of Tiger Communications are plainly sufficient to cause a prudent director to desire to look more closely at the records of Nostalgia. In addition, Mr. Marcovsky is a co-defendant with Mr. Kassan in a lawsuit filed on January 22, 1993, against them alleging illegalities in their management of other companies under their control. (Px. 26). In sum, there is ample evidence that Holdgreiwe has a bona fide need to inspect the corporate records in order to ensure that Mr. Marcovsky has not engaged in any mismanagement of Nostalgia.

It has generally been thought that once a director has established a proper purpose for the inspection of corporate records, any other motive or improper secondary purpose is irrelevant. *See CM&M Group, Inc. v. Carroll*, Del. Supr., 453 A.2d 788, 792 (1982); *General Time Corp. v. Talley Indus., Inc.*, Del. Supr., 240 A.2d 755 (1968); *Skouras v. Admiralty Enters., Inc.*, Del. Ch., 386 A.2d 674, 678 (1982). Defendant does not argue, however, that Holdgreiwe has improper secondary purposes for requesting inspection, but instead claims that Holdgreiwe's claim that he is conducting an investigation is a mere pretext and that his primary purposes are to improperly aid Concept and AVI in taking action hostile to Nostalgia and its interests. This claim is unproven.

Defendant argues that since the independent special committee of Nostalgia's board is already investigating management's activities, Holdgreiwe has no need to inspect the corporate records as part of his own investigation.

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claimed that Holdgreiwe's demand was part of an effort to aid Concept in litigation with GNM, however, Nostalgia has not made such a claim in this ensuing litigation.

According to the draft minutes of the March 3, 1993 meeting of the Concept-nominated directors of the Nostalgia board, at the meeting Ambassador Carmen made clear his dissatisfaction with the course of the investigation. The minutes report that Carmen stated that Nostalgia's regular counsel had prepared a biased report on management's behavior that he considered unsatisfactory. The minutes also state that the Special Committee had attempted to hire the law firm of Milbank, Tweed, Hadley & McCloy, but that management had not provided the funds for the required $25,000 retainer and that Marcovsky had declined to be interviewed by the committee, citing scheduling difficulties. In short the Special Committee's investigation, as of early March, was not proceeding well and, therefore, the board and Holdgreiwe had every reason to desire to supplement its efforts with an inspection of the corporate books and records of their own. (Px. 17).

Defendant also points to deposition testimony, in which Holdgreiwe states that he never asked the company's auditors to perform a fraud audit, as evidence that plaintiff is not truly interested in such an investigation. (Holdgreiwe Dep. at 93-94). In his testimony Holdgreiwe made clear that he lacks confidence in the company's auditors and believes they have been retained because of their flexibility in valuing certain assets of Nostalgia. (Holdgreiwe Dep. at 67-68). Holdgreiwe stated that he believes the auditors' flexibility "indicates . . . an inclination to accord with the desires of management that does not give me confidence in their ability to ferret out wrongdoing." (Holdgreiwe Dep. at 68). Thus, Holdgreiwe's failure to seek the assistance of Nostalgia's auditors in an investigation is an indication of his belief that their participation would not be helpful; not evidence that he has no interest in pursuing such an inquiry.

Defendant claims that Holdgreiwe falsely stated that he had an interest in reviewing the company's books and records to assure himself that Nostalgia's 10-K was correct before signing it as a director. Defendant argues that since the demand was issued only two days prior to the filing deadline for the 10-K, this claimed reason must be a pretext. I cannot agree with this reasoning. The deadline has come and gone, and although the 10-K was filed, it was filed without the signatures of Mr. Holdgreiwe and the other Concept-nominated members of the Nostalgia board. Plaintiff apparently had no intention of sifting through the corporate records in a mere two days because such haste was not required.

Defendant's suggestion that Holdgreiwe falsely claimed that his purpose arose in part from the 10-K filing is not supported by the record evidence. The record shows that Holdgreiwe's need for information regarding the 10-K filing arose from a concern that management wrongdoing had occurred and that management was seeking to conceal it by obtaining board approval of false S.E.C. filings. Holdgreiwe adequately explained this at his deposition; stating that the purpose of the demand was "[t]o discover whether and how much Mr. Marcovsky was taking from the Company," and that his "concerns with regard to the 10-K had to do with the fact that it didn't accurately reflect the financial transactions because Mr. Marcovsky's diversions were being covered up." (Holdgreiwe Dep. at 147).

Defendant's final contention is that Holdgreiwe seeks the inspection in an effort to aid Atlantic Video in its contract dispute with Nostalgia by putting pressure on Nostalgia's management. (Def. Br. at 18). This allegation has scant support on the record. There is a dispute between Nostalgia and AVI related to Nostalgia's effort to renegotiate a major studio services contract with AVI. (*See* Dx. 19, 20). AVI claims that Nostalgia has breached the contract by failing to pay its monthly fees for studio services. (Dx. 19). It is unclear how Holdgreiwe's demand for inspection could have materially increased the pressure on Nostalgia's management, as AVI had apparently already threatened to terminate the contract and cause Nostalgia to go "off the air," if it failed to meet AVI's demand for payment. (*See* Dx. 20). The record simply cannot support the conclusion that Holdgreiwe's demand had the primary purpose of pressuring Nostalgia on behalf of AVI.

[5] In *Helmsman Management Servs., Inc. v. A&S Consultants, Inc.*, Del. Ch., 525 A.2d 160 (1987), Helmsman, a minority stockholder, was permitted access to the books and records of A&S despite the existence of a major contract dispute between the parties. The court found that, although the stockholder was seeking to advance its interests both as a creditor and a stockholder of A&S, it was still entitled to inspect A&S's books and records since "the critical inquiry is whether the stockholder related purpose predominates over the ulterior purpose" and the stockholder related purpose did in fact predominate. *Id.* at 166-67.

In the present case, I find the allegation that Holdgreiwe has an ulterior purpose relating to AVI in seeking inspection of the corporate records to be unproven.

IV.

Defendant has failed to meet its burden of showing that Holdgreiwe's demand was made for an improper purpose, not reasonably related to his position as a director. Therefore, defendant will be ordered to allow Mr. Holdgreiwe to inspect its corporate books and records, promptly.

[6] This inspection, however, will be subject to appropriate limitations requested by defendant and designed to minimize the risk that any information obtained by Holdgreiwe through his inspection will not be misused by either Concept, or more significantly by AVI in its negotiations with Nostalgia.[3] *See CM&M Group*, 453 A.2d at 793-94.

Defendant has requested that Mr. Holdgreiwe be required to sign a confidentiality agreement prohibiting him from disclosing any information from Nostalgia's books and records and from trading on this information. Nostalgia also seeks to prohibit any person employed by AVI or any direct or indirect parent or affiliate of AVI, from participating in the inspection. Nostalgia proposes to extend this prohibition to Mr. Joo and Mr. Christopher Cates, both of whom are members of Nostalgia's board of directors and senior managers of AVI. Finally, defendant asks that the inspection not be permitted to interfere with operations of the Special Committee of Nostalgia's board.

Holdgreiwe has disclosed Nostalgia's financial information to AVI in the past, although I can make no statement about the materiality of such disclosure. (Holdgreiwe Dep. 46). In all events, his obligation not to do so should be apparent. But conditioning Holdgreiwe's right to inspect Nostalgia's corporate books and records on his entry into an agreement binding him not to disclose any of the information he obtains to any third parties, including AVI and Concept, seems to me to add little. He is already under an obligation to maintain the confidences of Nostalgia; to use its confidential information only to inform discussion among directors and action by the board or a committee. Disclosure of such information to AVI is a violation of duty whether or not an undertaking is entered. Thus, such an undertaking seems unnecessary. The single prior

3. It may be important that Nostalgia's financial information not be disclosed to AVI as Nostalgia is presently negotiating for modifications in its contract with AVI and may seek accommodation from AVI based on a claimed inability to pay the amounts provided for in the present contract.

incident of disclosure is not of such a character as to warrant other extraordinary steps by the court. Mr. Joo and Mr. Christopher Cates, who are members of Nostalgia's board are under similar constraints. That Joo is CEO of AVI creates a problem of the type that is foreseeable whenever director-interested transactions are entered into. These difficulties cannot be solved by holding him unable to inspect Nostalgia's books or to learn from fellow directors what is in them. Nevertheless it is apparent that he should proceed only with competent legal advice.

Defendant alleges that Mr. Joo has difficulty discerning when he is acting in his role as president of AVI and when he is acting as a director of Nostalgia. This allegation is based upon one comment by Mr. Holdgreiwe in his deposition in which he stated his opinion of Mr. Joo's understanding of his various official roles, in the context of explaining one particular occasion in which Mr. Joo asked Mr. Holdgreiwe for advice. (Holdgreiwe Dep. at 93). It is, therefore, without adequate evidentiary support.

[7] The difficult situation presented by the conflicting interests held by Joo and Cates is a result of agreements into which the parties have willingly entered. The court cannot, in the absence of evidence that Joo and Cates are breaching their fiduciary duties to Nostalgia, strip them of their rights as directors to full information concerning Nostalgia's affairs. Mr. Holdgreiwe will not be permitted to use in his inspection any professionals (accountants, lawyers or other advisors) who have been employed by Concept or any affiliate for any purpose other than this inspection of documents. The employment of such professionals by Holdgreiwe would create an unnecessary risk of exposure of corporate information to individuals with interests adverse to Nostalgia. *See Henshaw*, 252 A.2d at 130.

[8] Finally, the scope of Mr. Holdgreiwe's inspection will not be materially limited. In *Skoglund v. Ormand Indus., Inc.*, Del. Ch., 372 A.2d 204 (1976), it was held that where management wrongdoing was being investigated, the scope of the inspection could not be subjected to restrictions imposed by management. The court stated:

> If the plaintiffs are otherwise entitled to inspection of the corporate books . . . for the purpose of ascertaining the possible existence of corporate mismanagement . . . then their right should not be limited to those transactions . . . which have . . . aroused their suspicions. Rather it should extend to the corporate minutes and financial records in general . . . . [P]articularly in such a situation as this, the

> right should not be limited by the decision of present management that plaintiffs may inspect some records for this purpose, but not others.

Id. at 211. If Mr. Holdgreiwe's inspection of Nostalgia's records is to effectuate its purpose of enabling him to determine whether management wrongdoing has occurred, his access to Nostalgia's records must necessarily be broad and unrestricted. Therefore, plaintiff's demand, which requests detailed financial data, stock transfer books, tax information, intra-corporate communications, correspondence regarding potential investment in Nostalgia by third parties, press releases, and communications and filings with securities regulators, will be honored fully and completely.

Plaintiff is requested to prepare an appropriate form of order after consultation with defense counsel.

IN RE HOME SHOPPING NETWORK, INC. SHAREHOLDERS LITIGATION

No. 12,868 (Consolidated)

7547 CORP. v. LIBERTY MEDIA CORP.

No. 12,956

Court of Chancery of the State of Delaware, New Castle

May 19, 1993

Revised June 11, 1993

The individual plaintiffs in the consolidated case and the separately filed case are shareholders of Home Shopping Network (HSN) who, through putative class action suits, sought to enjoin defendant Liberty Media Corporation (Liberty) from consummating a partial tender offer which, if successful, would have given Liberty majority control of HSN voting stock. Responding to the increasing financial demands of the cable system operators who carry HSN's programming, the majority stockholder of HSN sought a strategic partnership between HSN and a large communications company. Seeking to

avoid violating the Delaware Business Combinations Act, Delaware Code Annotated, title 8, section 203, approval for the merger and acquisition of control of HSN by Liberty was sought from the HSN board. The merger proposal was approved by the board but was withdrawn by Liberty because of uncertainties arising as a result of allegations of improprieties in transactions between HSN and certain of its affiliates as well as certain legal actions and claims asserted against HSN. Liberty subsequently made a partial tender offer to purchase a controlling amount of outstanding HSN stock below its market price. Plaintiffs in the consolidated action sought injunctive relief solely on the grounds that defendants breached their fiduciary duty of complete candor through misleading statements contained in the offer to purchase, certificate of incorporation, and Schedule 14D-9 statement to stockholders disclosing the HSN board's position on the merger. Plaintiffs in the separate action sought injunctive relief alleging that Liberty's pending tender offer violated section 203 of the Delaware Business Combinations Act.

The court of chancery, per Vice-Chancellor Chandler, assessing preliminarily the probability that plaintiffs will be able, at trial, to establish the wrongs alleged, found that the plaintiffs in both the consolidated and separate cases failed to demonstrate a reasonable probability of success on both the disclosure and section 203 claims and denied both motions for a preliminary injunction.

1. Injunction ⟹ 138.15, 138.21

An applicant seeking preliminary injunctive relief has the burden of establishing: (1) a reasonable likelihood of success on the merits of her claims, (2) that she will suffer irreparable harm before a final hearing may be had, and (3) that the harm to the plaintiff if the injunctive relief is denied outweighs the harm to the defendants if injunctive relief is granted.

2. Corporations ⟹ 584

Securities Regulation ⟹ 144

In order to demonstrate that an omission breaches the duty of candor, the plaintiffs must show that the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood

that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of the information available.

3. Corporations ⟹ 18

Since a certificate of incorporation is viewed as a contract among shareholders, Delaware courts are required to give effect to the intent of the parties as revealed by the language of the certificate and the circumstances surrounding its creation and adoption.

4. Injunction ⟹ 138.48

After close analysis of the scope and purpose of the Business Combinations Act, if tender offer is not a "business combination" under any subsection of Delaware Code Annotated, title 8, section 203, then the section 203 plaintiffs have failed to demonstrate a reasonable probability of success on the merits of their case, as required for issuance of a preliminary injunction. DEL. CODE ANN. tit. 8, § 203 (repl. vol. 1991).

5. Statutes ⟹ 179

According to the language and intent of the statute, stockholder's partial tender offer, in which its equity interest may be increased from twenty-three percent to forty percent, is not a transaction covered by section 203's definition of a "business combination." DEL. CODE ANN. tit. 8, § 203 (repl. vol. 1991).

6. Statutes ⟹ 190

When the language of a statute is clear and unambiguous, there is no need for statutory interpretation.

7. Statutes ⟹ 216

Where a term employed in a statute is not clear and unambiguous on its face, it is necessary to examine the underlying purpose of the statute.

8. Securities Regulation ⟹ 278

The primary purpose of the three-year waiting period on "business combinations" is to protect independent stockholders by pre-

cluding interested stockholders (acquirers) from using their equity positions to induce the (target) corporation into certain transactions. This purpose is not thwarted by virtue of a partial tender offer by an interested stockholder that has the effect (potentially) of increasing its interest from twenty-three percent to forty percent of the corporation's equity. DEL. CODE ANN. tit. 8, § 203 (repl. vol. 1991).

9. Corporations ⟹ 310(1)

Section 203 does not "confer a direct role upon the board with respect to tender offers." Therefore, a partial tender offer is not a "business combination" within the meaning of the statute. DEL. CODE ANN. tit. 8, § 203(c)(3)(iv) (repl. vol. 1991).

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CHANDLER, *Vice-Chancellor*

This is the decision on motions to preliminarily enjoin the consummation or closing of a partial tender offer by defendant Liberty Media Corporation ("Liberty"). In an offer that expires at midnight on May 20, 1993, Liberty seeks to purchase up to 15 million outstanding public shares of defendant Home Shopping Network, Inc.'s ("HSN") common stock at $7 net per share. If Liberty's offer is fully subscribed, Liberty's equity interest in HSN will increase from 23% to 40%, while its voting power will grow from 65% to 70%. In addition to Liberty, HSN and Liberty Program Investments, Inc. (a subsidiary of Liberty), the complaints in these actions name as defendants various present and former directors of HSN and Liberty. The individual plaintiffs who filed these putative class actions are owners of HSN common stock.

The amended supplemental complaint in the consolidated case (No. 12,868) and the complaint in the separately filed case (No. 12,956) both seek to enjoin Liberty's partial tender offer. However, the allegations in the two complaints are not at all similar and the legal theories on which they base their right to relief are entirely different. In fact, the only similarity between the consolidated case and the separate case is the request to enjoin Liberty's partial tender offer. Consequently, after describing the factual background in part I of this Opinion, I address the legal theories of each complaint separately. Part II describes the standards applied by this Court in injunctive proceedings. Part III addresses the disclosure claims raised in the consolidated case, while part IV analyzes the 8 *Del. C.* § 203 claim asserted in No. 12,956. Finally, my conclusions are continued in part V of the Opinion.

I.

HSN is a Delaware corporation and has its principal executive offices in St. Petersburg, Florida. It is a holding company with subsidiaries that sell a variety of consumer products by means of live, customer-interactive televised sales programs, known as the "Home Shopping Club." HSN had, as of November 1992, approximately 64 million shares of common stock issued and outstanding held by approximately 9,562 stockholders of record. It also had, as of March 1993, about 24 million shares of class B common stock, all of which were held, until February 11, 1993, by defendant Roy Speer, HSN's chairman, through RMS, a Nevada limited partnership of which Speer is the majority partner and through which Speer held most of his HSN stock. Before February 11, 1993, and by virtue of his ownership of class B stock, Speer controlled HSN.

Liberty is a Delaware corporation and has its principal executive offices in Denver, Colorado. Liberty is in the cable television and cable programming business. Defendant Liberty Program Investments, Inc. ("LPI") is a Wyoming corporation and an indirect wholly-owned subsidiary of Liberty. Liberty and LPI are referred to throughout this Opinion as Liberty.[1]

As a result of the increasing financial demands of the cable system operators who carry HSN's programming, Speer, with the approval of the HSN board, had been considering a strategic partnership between HSN and a large communications company. On December 2, 1992, at a convention in California, Speer discussed with Peter Barton and John Malone the prospect of Liberty acquiring control of HSN from Speer. Malone agreed to meet with Speer later that week in Denver to discuss the proposal. At a meeting in Denver on Friday, December 4, 1992, discussions of a possible sale proceeded between HSN representatives Speer, Wandler, and Frances Santangelo (a financial consultant to HSN) and Liberty representatives

1. The individual defendants are: John C. Malone, chairman of Liberty; Peter R. Barton, Liberty's president and chief executive officer as well as a Liberty director; Robert R. Bennett, Liberty's senior vice president, treasurer, and secretary and a Liberty director; John M. Draper, Liberty's senior vice president and general counsel; Gerald F. Hogan, president and CEO of HSN and a member of the board of directors of HSN; Anthony Forstmann, director of HSN; John J. McNamara, a former director of HSN who resigned on May 3, 1993; and Les R. Wandler, executive vice president, secretary and chief financial officer of HSN and a director of HSN until February 11, 1993.

Robert Bennett, Draper, and Malone. During these discussions, Malone allegedly insisted that the HSN board first approve the possible acquisition of control by Liberty in order to avoid complications under 8 *Del. C.* § 203. Since the full HSN board was unable to conduct a meeting on such short notice, three members of HSN's Executive Committee, Wandler, Ramsey, and Speer, conducted a telephone conference during the middle of the afternoon on December 4. The Executive Committee, with Speer abstaining, voted to approve the proposed sale of control over HSN to Liberty. Evidently, Speer and Wandler also separately polled the other members of the HSN board that same day, advising Malone that all of HSN's directors also approved the decision by the HSN Executive Committee.

Negotiations between Malone and Speer continued into the late evening of December 4, and were finally concluded on Saturday morning, December 5. An agreement in principal between Liberty and RMS was executed on December 5, pursuant to which Liberty agreed to purchase from RMS 20 million shares of HSN class B common stock for $60 million in cash and four million shares of Liberty class A common stock, a package worth about $7.20 per HSN class B share on December 5, 1992. The agreement also provided that upon Liberty's request, RMS would convert any additional shares of class B HSN common stock it held into HSN common stock, as permitted under HSN's certificate of incorporation.

On February 11, 1993, following certain revisions to the agreement in principal and various regulatory approvals, Liberty acquired 20 million HSN class B shares from RMS upon the payment of $58 million in cash and the issuance to RMS of four million shares of Liberty class A common stock. Because Liberty's class A common stock on February 11, 1993, had increased in value almost 46% since the execution of the agreement in principal on December 5, 1992, the package was worth about $9 per HSN class B share on February 11. When the shares acquired from RMS were added to the shares of HSN that Liberty already owned, Liberty controlled about 23% of HSN's outstanding equity securities and approximately 65% of the outstanding voting power of HSN.

RMS continues to hold about four million HSN class B shares that were not purchased by Liberty, subject to its agreement to convert such class B shares into common stock from time to time at the request of Liberty or before any sale or pledge of such shares.

After closing on the RMS sale on February 11, 1993, Liberty delivered a proposal (the "merger proposal") to HSN's board of

directors to acquire all the remaining common stock of HSN not already owned by Liberty for a package of cash and stock valued at $9 per share. In response to the merger proposal, HSN's board appointed an independent committee of directors who were not employees of either HSN or Liberty to review and consider the merger proposal and to negotiate the terms and conditions of any agreement relating to it. This special committee consisted of HSN outside directors Forstmann and McNamara. They retained the First Boston Corporation and the law firm of Baker & McKenzie to advise them regarding the merger proposal. On February 23, 1993, Liberty advised the special committee that the merger proposal had been revised to provide that each holder of HSN common stock other than Liberty would receive $5.50 in cash and one-tenth of a share of Liberty class A common stock, a package of cash and securities valued at about $8.50.

On April 9, 1993, Liberty withdrew the revised merger proposal. Liberty advised HSN's special committee that Liberty was withdrawing the proposal because of uncertainties arising as a result of allegations of improprieties in transactions between HSN and certain of its affiliates as well as certain legal actions and claims asserted against HSN, all of which were thought likely to cause a delay in consummating the merger proposal. At the time the merger proposal was withdrawn, First Boston had not completed its review or advised the special committee as to its view regarding the fairness or adequacy of the merger proposal. Thus, the special committee had not completed its consideration of the merger proposal, although it had discussed it with legal counsel and First Boston. Upon withdrawal of the merger proposal, HSN's board of directors formally dissolved the special committee.

On April 23, 1993, Liberty made a partial tender offer to purchase up to 15 million shares of HSN stock at $7 per share. HSN's special committee was reappointed, again consisting of outside directors Forstmann and McNamara, to review the partial tender offer and make a recommendation to the HSN board as to how HSN should fulfill its disclosure requirements or obligations under the Securities Exchange Act. The special committee again met with and retained Baker & McKenzie to act as its legal counsel and authorized Baker & McKenzie to retain First Boston to act as the committee's financial advisor. The committee scheduled a May 4 meeting with First Boston to discuss its review of the partial tender offer. However, on May 3, McNamara resigned from HSN's board of directors. Because HSN's bylaws provide that any committee of the board

must consist of at least two members, McNamara's resignation meant that the special committee consisted of fewer than two board members and could not validly function under HSN's bylaws. Consequently, the special committee (consisting only of Forstmann) took no further action with regard to the partial tender offer. First Boston was advised by Baker & McKenzie that the special committee could no longer function, but First Boston nonetheless was requested to present its report to the HSN board on May 5.

At the May 5 meeting, First Boston presented to HSN's board a preliminary reference value range of the long-term intrinsic value of HSN of $8.54 to $12.32 per share of HSN common stock. First Boston qualified its view as to this range of value by indicating that it did not consider the effect of the pending litigation and criminal investigations concerning HSN nor did it consider that the partial tender offer is for less than all of HSN's outstanding shares. First Boston's view also did not give effect to the fact that Liberty currently possesses effective voting control over HSN and has no interest in selling its HSN shares, thereby eliminating any opportunity to capture a control premium by the minority stockholders. First Boston advised the board on May 5 that, had these factors been taken into account, the range of long-term values for HSN might have been lower, although it did not quantify the magnitude of reduction in the range of value. First Boston was not asked for and did not provide an opinion as to the fairness or adequacy of the partial tender offer.

After First Boston's presentation to HSN's board, a majority of the board members, recognizing that five out of the six members had a conflict of interest regarding the tender offer, directed HSN's management to disseminate a Schedule 14D-9 to HSN's stockholders explaining that HSN was unable to take a position on the tender offer and describing the reasons for HSN's inability to take a position. The 14D-9 also disclosed the reasons for the special committee's inability to evaluate the tender offer, summarized First Boston's May 5 presentation to the board, and explained that none of HSN's officers or directors intended to tender their HSN shares into Liberty's offer.

I I.

[1] An applicant seeking preliminary injunctive relief has the burden of establishing: 1) a reasonable likelihood of success on the merits of her claims, 2) that she will suffer irreparable harm before a final

hearing may be had, and 3) that the harm to the plaintiff if injunctive relief is denied outweighs the harm to the defendants if injunctive relief is granted. *Ivanhoe Partners v. Newmont Mining Corp.*, Del. Ch., 533 A.2d 585, 600, *aff'd*, Del. Supr., 535 A.2d 1334 (1987).

III.

For purposes of this motion, plaintiffs in the consolidated action contend they are entitled to injunctive relief solely because defendants have breached their fiduciary duty of complete candor. Plaintiffs' attack is directed at alleged omissions and misstatements in the Schedule 14D-9 filed by HSN and in Liberty's April 23, 1993 offer to purchase. That is, plaintiffs in the consolidated action ask that I enjoin the partial tender offer because HSN's board and Liberty have failed to disclose material information to HSN's public shareholders.

[2] In order to demonstrate that an omission breaches the duty of candor, the plaintiffs must show that the "omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of the information available." *Rosenblatt v. Getty Oil Co.*, Del. Supr., 493 A.2d 929, 944 (1985) (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).

I will address each disclosure claim individually. Plaintiffs must establish a reasonable likelihood of success on the merits of the disclosure claims, as a whole, to meet the first prong of the standard for a preliminary injunction. Obviously, the preliminary relief sought here provides no occasion to resolve finally the legal and factual issues raised in these actions. All that I am called upon to do at this stage is assess preliminarily the probability that plaintiffs will be able, at trial, to establish the wrongs alleged.[2]

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2. The consolidated action sets forth, in a supplemental complaint, a number of claims aside from the disclosure claims, including: that Speer and RMS breached their fiduciary duties in agreeing to the sale of control to Liberty and that Liberty aided and abetted Speer and RMS in this wrong; that Liberty has breached fiduciary duties by commencing an unfairly priced, improperly timed, coercive, and manipulative tender offer; that the members of HSN's board have breached their fiduciary duties of loyalty, due care, and candor by failing to protect the public stockholders

A. The Claim That Liberty Has Mislead HSN Stockholders About The Reasons For Liberty's Withdrawal Of Its Revised Merger Proposal

Plaintiffs contend that Liberty has attempted to mislead HSN's stockholders into believing that the partial tender offer is the only realistic opportunity for HSN stockholders to dispose of their shares above market value because of HSN's bleak future. This "smoke screen," according to the plaintiffs, results from statements in Liberty's offer to purchase concerning the factors that caused Liberty to withdraw the revised merger proposal that it made to HSN's board after Liberty acquired its controlling interest from Speer and RMS. For example, plaintiffs point to the following provision in the offer to purchase:

> Since Liberty entered into an agreement to acquire a controlling interest in the company, certain allegations have been made and litigation has been commenced relating to purported improprieties in transactions between the company and certain of its affiliates and others. Liberty determined that such allegations and claims, particularly those which came to light subsequent to the making of the merger proposal, including published reports of a pending investigation by a federally constituted grand jury into the activities of certain former executive officers of the company, had created uncertainties relating to the proposed merger which made it unadvisable for Liberty to proceed. As a result, Liberty withdrew the merger proposal on April 9, 1993.

See Offer to Purchase (Apr. 23, 1993) Defs. Ex. 1. Plaintiffs attack this statement on the ground that it does not accurately reflect the reasons that caused Liberty to withdraw its merger proposal and because the alleged "uncertainties" are not expected to have a material adverse effect on HSN's business prospects and financial performance.

Having read the offer to purchase in its entirety, I cannot conclude at this juncture that the disclosure regarding Liberty's reasons for withdrawing its merger proposal are misleading or false.

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of HSN from Liberty's unfair and coercive tender offer; and that HSN has violated 8 *Del. C.* § 211 as a result of its failure to hold an annual stockholders meeting within the period specified in § 211. These claims were not argued before me during the preliminary injunction hearing and, therefore, they are not addressed here.

Nor can I find that Liberty has omitted information that a reasonable stockholder would find material.

It is undisputed that Liberty withdrew its merger proposal because the uncertainties surrounding the proposed merger created by the lawsuits and pending investigations would likely delay the proceedings associated with the merger proposal, thus jeopardizing the merger proposal. That fact is set forth in the offer to purchase where it reproduces a letter from John Draper, Liberty's senior vice president, to HSN's special committee. In that letter, Liberty advised HSN of its decision to withdraw the merger proposal. Draper's letter ends with this statement: "Because of the uncertainties concerning the proposed merger created by such allegations, and the delays in proceedings to act upon the merger proposal which may result therefrom, Liberty hereby withdraws its merger proposal." Offer to Purchase, Defs. Ex. 1, at 20.

In addition, considering the offer to purchase as a whole, I cannot find that statements regarding the uncertainties affecting HSN as a result of certain criminal investigations and civil lawsuits, and the claims against certain present and former vendors to HSN, would have the one-sided effect posited by plaintiffs. Contrary to the references to the uncertainties resulting from the litigation, the offer also frequently emphasizes Liberty's confidence in HSN's viability and future. Indeed, in the paragraph immediately following the one that describes the uncertainties resulting from certain litigation and criminal investigations, the offer to purchase notes that

> Liberty continues to believe in the fundamental soundness of the company's business and in the ability of new management to improve the company's recent disappointing operating results, and Liberty's decision to make the offer reflects Liberty's confidence in the company's financial viability and future. Liberty believes that the purchase of the shares pursuant to the offer will enable it to participate to a greater extent in any future growth in the value of the company.

Id. The offering document also describes the allegations in certain lawsuits, both individual and derivative, reports the nature of the lawsuits, and ends by noting that such actions are being "vigorously defended" and that "meritorious defenses" are believed to exist with respect to them.

In short, while the offering document recites the uncertainties caused by litigation and other allegations about HSN and certain

executive officers, it also contains numerous references to Liberty's belief in the soundness of HSN's business. It sets forth the text of the letter to HSN regarding the reasons for withdrawal of the merger proposal, namely, the delay occasioned by the litigation. Accordingly, I cannot conclude preliminarily that statements in the offer to purchase regarding the circumstances surrounding the withdrawal of Liberty's revised merger proposal are misleading or that additional disclosures as proposed by the plaintiffs would add meaningfully to the information already available to the stockholders.

B. The Allegedly Misleading Statements Regarding HSN's Certificate Of Incorporation

Plaintiffs next argue that the offer to purchase and the Schedule 14D-9 are misleading because they suggest that, under HSN's certificate of incorporation, if the total number of class B shares falls below 22.8 million (an event that Liberty can trigger), the common stock and class B stock would vote together on any fundamental corporate transaction involving HSN, including a merger proposal. Because Liberty's ownership of 20 million class B shares entitles it to ten votes for each share under HSN's charter, or 200 million votes, Liberty can guarantee approval of any such fundamental corporate transaction.

According to the plaintiffs, however, the two classes of common stock of HSN vote *separately* on all fundamental corporate transactions, including mergers, regardless of whether the number of class B shares falls below 22.8 million. Plaintiffs insist that disclosures to the contrary in the offer and the Schedule 14D-9 are material misrepresentations which have the coercive effect of forcing holders of HSN common stock to tender to Liberty because they are erroneously told that, in the event Liberty makes a merger proposal, HSN stockholders may not have the right to a class vote and, thus, Liberty arguably would be free to acquire the remaining equity interest in HSN without the obligation to secure the consent of the holders of HSN common stock.

Plaintiffs are correct that the offer to purchase and the Schedule 14D-9 state that in the event that there are fewer than 22.8 million HSN class B shares outstanding, the holders of class B shares would vote *with* the holders of HSN common stock as a single class on fundamental corporate transactions, including a merger. These documents also state that Liberty has the ability to reduce the number of outstanding HSN class B shares below 22.8 million, thereby

causing the holders of HSN common stock and HSN class B shares to vote together as a single class on a major transaction. *See* Offer to Purchase, Defs. Ex. 1 at 14; HSN's Schedule 14D-9, Defs. Ex. 2 at 6. Plaintiffs' assertion that these statements violate the clear and straightforward provisions of HSN's certificate of incorporation, however, is mistaken, as is illustrated by the disputed charter provisions. They provide as follows:

> A(3) The holders of Common Stock shall vote as a separate class upon any merger, reorganization, recapitalization, liquidation, distribution or winding-up, sale, transfer, or hypothecation of substantially all or a substantial portion of the assets of the Corporation, or similar corporate matter, and any amendment to this Certificate of Incorporation, all of which must be submitted to a vote of or to the consent of the stockholders of the Corporation; and the requisite approval of the holders of the Common Stock, voting as a class, shall be necessary for the adoption of any such matter.
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> * * *
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> B(3) So long as at least twenty-two million eight hundred thousand (22,800,000) shares of Class B Common Stock are outstanding, the holders of said shares of Class B Common Stock shall vote as a separate class upon any *merger*, reorganization, recapitalization, liquidation, dissolution or winding-up, sale, transfer, or hypothecation of substantially all or a substantial portion of the assets of the Corporation, all of which must be submitted to a vote or to the consent of the Stockholders of the Corporation; and the requisite approval of the holders of the Class B Common Stock, voting as a class, shall be necessary for the adoption of any such matter. *In the event that less than twenty-two million eight hundred thousand (22,800,000) shares of Class B Common Stock are outstanding, the shares of Class B Common Stock shall vote with the holders of shares of Common Stock as to the matters described in this Subsection (3)*, but such shares of Class B [C]ommon Stock shall be entitled to vote ten votes per share on such matters. (Emphasis added).

Giving the words in these provisions their plain, ordinary meaning, I cannot conclude, preliminarily, that the provisions are ambiguous or that section A(3) provides for separate class voting on fundamental corporate transactions *regardless* of the number of class B shares outstanding. Section B(3) is the only provision of HSN's charter

that addresses the voting rights of *both* classes of HSN stock in the specific context of a merger. Section B(3) requires a single vote of both classes of HSN stock under a defined circumstance—that is, the class B shares "shall vote with" the common stock where fewer than 22.8 million class B shares are outstanding. Nothing in section A(3) or section B(3) suggests that the holders of common stock are entitled to vote separately as a class on a merger proposal or similar transaction if there are fewer than 22.8 million outstanding class B shares. Section B(3) clearly and unambiguously defines the circumstances in which a separate class vote of the common stock is not required or permitted.

[3] This reading of the certificate of incorporation assigns the words in sections A(3) and B(3) their ordinary meaning and is consistent with the clear and unambiguous language that appears in those provisions. Since a certificate of incorporation is viewed as a contract among shareholders, Delaware courts are required to give effect to the intent of the parties as revealed by the language of the certificate and the circumstances surrounding its creation and adoption. *Waggoner v. Laster*, Del. Supr., 581 A.2d 1127, 1134 (1990). The more specific provisions of section B(3) clearly specify that the two classes of HSN stock "shall vote" together except when the number of HSN class B shares exceeds 22.8 million. At this preliminary stage, I cannot find that plaintiffs' interpretation is supported by the plain language of the charter. Nor can I find that plaintiffs' interpretation is reasonably likely to prevail when the provisions in A(3) and B(3) are considered in the context of the entire instrument. *See Sullivan Money Management, Inc. v. F.L.S. Holdings, Inc.*, Del. Ch., No. 12,731, Jacobs, V.C. (Nov. 20, 1992), slip op. at 8 (quoting *Warner Communications, Inc. v. Chris-Craft Indus., Inc.*, Del. Ch., 583 A.2d 962, *aff'd*, Del. Supr., 567 A.2d 419 (1989)) (certificate of incorporation must be construed in its entirety in order to determine the meaning intended to be given any portion of it). Furthermore, at this stage it appears that other provisions of the charter support the defendants' interpretation. For example, HSN's charter, in section C(4), seeks to protect the holders of HSN common stock from complete dominance in the election of directors by providing that, "notwithstanding anything to the contrary in this certificate of incorporation," the holders of HSN common stock always will be entitled to elect 25% of the company's directors. This provision suggests that the draftsmen of HSN's charter recognized that a separate class vote was limited by the terms of section B(3) and, in order to assure the holders of HSN common stock a separate class vote with respect to 25% of

the company's directors, section C(4) was written to provide such protection "notwithstanding" the super-voting power of the class B shares under section B(3).

The plaintiffs, however, vigorously contend that sections A(3) and B(3) are at least ambiguous, pointing to statements by Malone of his "understanding" that a separate class vote of the common stock would be required for a merger and to recent actions by HSN's board to amend the certificate to clarify the circumstances when class B shares would vote as a single class with the common stock. The defendants' actions, together with Malone's statements, plaintiffs assert, confirm the presence and the materiality of ambiguity in the certificate provisions. Although I find Malone's statements and the HSN board's proposed amendments to HSN's certificate and bylaws puzzling,[3] nonetheless, the provisions of HSN's certificate define in a reasonably clear fashion, in my opinion, the specific circumstances when a class vote is not permitted under HSN's charter. Thus, I cannot say at this juncture that it appears reasonably likely that plaintiffs will prevail on this aspect of their disclosure claim.

C. Alleged Misrepresentations Regarding The Work Of The Special Committee And The Report By First Boston

Plaintiffs insist that the 14D-9 misleadingly portrays the activities of the HSN board and special committee. The 14D-9 describes, in chronological fashion, the background of Liberty's partial tender offer, including the revised merger proposal and withdrawn merger proposal, followed by the appointment of the special committee on April 28. Specifically, plaintiffs complain that the 14D-9 fails to disclose that the special committee never met regarding the partial tender offer, that McNamara resigned from the special committee because of his unwillingness to get involved in this litigation, that HSN's bylaws would have permitted the HSN board to amend the bylaws to permit Forstmann, as a one-member special committee, to complete the committee's work; and, finally, that HSN's board could have asked First Boston for a fairness opinion regarding the partial tender offer. The defendants respond that the disclosures in the 14D-9 are, in fact, accurate and, in any event, the additional information proposed by plaintiffs would not add significantly to the mix of information already before HSN's stockholders.

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3. Liberty's counsel explained these actions, in part, as an overly-cautious, "belt and suspenders," reaction by HSN's legal advisers.

With regard to the actions taken by the special committee in response to the tender offer, the Schedule 14D-9 includes the following:

> On April 20, 1993, the independent committee met and retained Baker & McKenzie to act as its legal counsel and authorized the retention of First Boston to act as its financial adviser. The independent committee also scheduled a meeting for May 4, 1993, during which it was scheduled to meet with senior executives of the company of [HSN] and First Boston to discuss [HSN] and the offer. The independent committee requested that First Boston be prepared to present its advice with respect to the offer at such meeting.
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> On May 3, 1993, prior to the scheduled second meeting of the independent committee, Mr. McNamara resigned from the board of directors of [HSN]. The bylaws of [HSN] mandate that any committee of the board of directors must consist of at least two board members. Thus, with Mr. McNamara's resignation, under [HSN's] bylaws, the independent committee could take no action with respect to the offer. As a result, the independent committee held no further meetings and did not confer with First Boston following the May 3, 1993, resignation of Mr. McNamara, and could not report to the board of directors.

This chronology of events involving the special committee indicates that the committee did take certain actions with regard to the tender offer, including the retention of Baker & McKenzie and First Boston. It would be inaccurate, therefore, to say that the committee did nothing or never met. I also am unsure how the information actually presented in the 14D-9 regarding the committee's work is likely to affect the consideration of a reasonable stockholder. In short, I do not find it reasonably likely that plaintiffs will prevail at a final hearing on their claim that the Schedule 14D-9 misleadingly portrays the activities of the special committee.

Likewise, I doubt that plaintiffs ultimately will prevail on the claim that the 14D-9 should have disclosed that the real reason for McNamara's resignation from the board was his unwillingness to participate in this litigation. Plaintiffs point to deposition testimony of a representative of First Boston, as well as by Messrs. Forstmann and Bennett, that support plaintiffs' characterization of the reasons for McNamara's resignation. On the other hand, McNamara's af-

fidavit submitted in connection with the pending motions denies that he resigned because of this litigation. Ultimately, however, I need not be concerned with this conflict in the testimony because I cannot find at this preliminary stage that whatever personal or business reasons McNamara had for resigning on May 3 would have been material to a reasonable stockholder in considering the tender offer.

Plaintiffs' claim that in light of McNamara's resignation, HSN's board should have amended HSN's bylaws to permit Forstmann to act as a one-member committee to review the tender offer also does not appear to be information that a reasonable stockholder is substantially likely to consider material information in considering whether or not to tender into Liberty's offer. McNamara's resignation came on May 3, one day before the scheduled meeting with First Boston. The board met on May 5 with First Boston, where its findings were presented. Given that HSN's board consisted of four inside directors affiliated with Liberty, it seems dubious whether a decision to amend the bylaws allowing Forstmann to act as a one-person committee would constitute information likely to be considered material by a reasonable stockholder.

Plaintiffs next argue that the board could have invited First Boston to render a formal opinion on the fairness of the partial tender offer and that the Schedule 14D-9 should have stated this fact. It is undisputed, however, that the 14D-9 does describe the terms of First Boston's retention by the special committee, the work performed by First Boston, and the results presented during the May 5, 1993, HSN board meeting. The Schedule 14D-9 sets forth First Boston's reference value range for HSN's long-term intrinsic valuation, as well as the various qualifications to First Boston's views regarding that value range. Considering the full text of the disclosure (*see* Schedule 14D-9, Defs. Ex. 2 at 11-12), I cannot conclude preliminarily that these statements are misleading, or that the additional disclosure that the board could have asked for a fairness opinion, would add meaningfully to the mix of information provided here to HSN's stockholders.

Finally, plaintiffs attack statements in the 14D-9 that describe a special committee, formed by HSN's board on March 4, 1993, to review compliance with regulatory requirements and related-party transactions. Liberty took this action as the result of a series of allegations made by Allen P. Allweiss, a former executive vice president and general counsel to HSN, against Speer and HSN. Plaintiffs complain that the disclosures regarding this special committee created by Liberty's insistence and composed of Malone, Barton, and Ben-

nett, are misleading in that, contrary to the impression created by the disclosures, the committee has done nothing to date in connection with its inquiry.

The Schedule 14D-9 states that "[t]he Special Committee has retained legal counsel to review certain matters described above. As of the date of this Schedule, neither the Special Committee nor its counsel has completed its review of these matters. The Special Committee has indicated that it cannot currently give an approximate date on which it will complete the review." Schedule 14D-9, Defs. Ex. 2 at 20-21.

I am unsure how plaintiffs believe this statement falsely implies that the special committee is actively pursuing its investigations and review. It appears to describe what the committee has done to date and leaves completely open-ended what it expects to do and when it expects to complete its review. In any event, it is not clear how the efforts of the special committee would be material to a stockholder considering whether or not to accept Liberty's partial tender offer. Plaintiffs have not argued that a reasonable stockholder would be more (or less) likely to tender her stock after reading this section of the 14D-9. As I do not understand how this particular information would be material in the deliberations of a reasonable stockholder, I cannot find preliminarily a reasonable probability that plaintiffs will ultimately succeed with regard to this claim.

I V.

The plaintiffs in No. 12,956 (the "section 203 plaintiffs") allege that Liberty's pending tender offer violates the Delaware Business Combinations Act, 8 *Del. C.* § 203. The section 203 plaintiffs allege that: 1) defendants' contention that there was prior approval of the tender offer by the board is false; 2) the tender offer qualifies as a "business combination" under the statute; and 3) if the tender offer is not enjoined, plaintiffs will be irreparably injured because the protections of section 203 will be rendered nugatory. Therefore, the section 203 plaintiffs, like the plaintiffs in No. 12,868, seek to enjoin the pending tender offer.

[4] After a close analysis of the scope and purpose of the Business Combinations Act, I conclude preliminarily that Liberty's tender offer is not a "business combination" under any subsection of 8 *Del. C.* § 203 and, therefore, the section 203 plaintiffs fail to demonstrate a reasonable probability of success on the merits of their case.

The Business Combinations Act is a relatively new statute (adopted in 1988) designed to protect shareholders against unfair takeovers and business combinations. Because it is such a new statute, case law construing section 203 is scant, and its meaning must be distilled from its language, its purpose, and knowledgeable secondary sources and commentary.

The statute begins "(a) Notwithstanding any other provisions of this chapter, a corporation shall not engage in any business combination with any interested stockholder for a period of 3 years following the date that such stockholder became an interested stockholder . . . ." 8 *Del. C.* § 203(a). The statute later provides a detailed definition of the term "business combination" in subsection (c)(3). Subsection 203(a) also contains numerous exceptions to the three-year moratorium on business combinations.[4]

[5] Plaintiffs argue that the tender offer is a business combination, as defined in section 203(c)(3)(iv). They note that the tender offer, if completed, will increase Liberty's proportionate share of HSN's stock from 23% to 40%, approximately. Plaintiffs also assert that Liberty concedes the tender offer is a "business combination" in its offer to purchase. Although in their briefs defendants do challenge the application of section 203, they focus mainly upon the HSN board's alleged approval of Liberty's actions on December 5, 1992, under section 203(a)(1). However, according to the language and intent of the statute, I believe Liberty's partial tender offer, in which its equity interest may be increased from 23% to 40%, is not a transaction covered by section 203's definition of a "business combination." Thus, I find it unnecessary to address the issue of whether there was a prior approval by HSN's board of the earlier transaction by which Liberty became an interested stockholder.

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4. Subsection (a) sets forth three ways an interested shareholder otherwise subject to the section may escape its moratorium on business combinations. It allows an interested stockholder to consummate a second step merger or other business combination where: 1) the board approves the combination prior to the date the offeror becomes an interested stockholder; 2) the transaction which transforms the stockholder into an interested stockholder results in the interested stockholder owning at least 85% of the outstanding voting stock, excluding for the purposes of calculating that percentage shares owned by officers who are also directors and certain employee stock plans; and 3) the board of directors approves the business combination after the person becomes an interested stockholder and the proposed combination is authorized by 66 2/3% of the outstanding voting stock not owned by the interested stockholder. *See BNS, Inc. v. Koppers Co.*, 683 F. Supp. 458, 465 (D. Del. 1988).

[6-7] Of greatest importance in statutory interpretation is the plain language of the statute itself. When the language of the statute is clear and unambiguous, there is no need for statutory interpretation. *Sostre v. Swift*, Del. Supr., 603 A.2d 809, 813 (1992). In this regard, section 203(c)(3) specifically defines a "business combination." To paraphrase, the definition of business combination basically includes: 1) mergers and consolidations with interested stockholders; 2) any sale, lease, exchange, pledge, disposition, or similar transaction to or with an interested stockholder if the transaction involves corporate assets valued at over 10% of the market value of the corporation's stocks or aggregate assets; 3) issuance of stock or other securities or other transactions that increase an interested stockholder's proportionate ownership of any class or series of stock; 4) any other transaction that confers a financial benefit on an interested stockholder by or through the corporation; and 5) receipt of financial benefits by an interested stockholder in loans or other financial benefits provided by the corporation. 8 *Del. C.* § 203(c)(3).

Plaintiffs do not argue that Liberty's partial tender offer is a "business combination," as defined in categories 1, 2, 3, or 5. Similarly, I find these definitions of business combinations—merger and consolidations, sale of assets or stock, issuance or transfer of stock, and financial benefits—are inapplicable to the situation at hand. Plaintiffs assert, however, that the fourth category of a "business combination," as stated in subsection 203(c)(3)(iv), applies to Liberty's partial tender offer because it has the effect of increasing the interested shareholder's (Liberty's) ownership of stock. This subsection states:

> (3) "[B]usiness combination," when used in reference to any corporation and any interested stockholder of such corporation, means: . . .
> (iv) any transaction *involving the corporation* or any direct or indirect majority-owned subsidiary of the corporation which has the effect, directly or indirectly, of increasing the proportionate share of the stock of any class or series, or securities convertible into the stock of any class or series, of the corporation or of any such subsidiary which is owned by the interested stockholder, except as a result of immaterial changes due to fractional share adjustments or as a result of any purchase or redemption of any shares of stock not caused, directly or indirectly, by the interested shareholder . . . .

8 *Del. C.* § 203(c)(3)(iv) (emphasis added).

The question before me, then, is whether the clause "involving the corporation" necessarily applies to a partial tender offer by an interested shareholder. Plaintiffs assert that it does; defendants disagree. The statute itself does not further clarify the phrase.

Plaintiffs argue that Liberty "concedes" that the partial tender offer is a business combination because it addresses the ramifications of section 203 in its offer to purchase. Specifically, Liberty's offer to purchase states that the HSN board approved the December 5, 1992, sale of stock from RMS/Speer to Liberty, thereby exempting Liberty and HSN from section 203.[5] Therefore, Liberty's offer to purchase does not address the possibility that section 203 may not apply to the tender offer, but relies instead upon the assumption that a statutory exception is present under 8 *Del. C.* § 203(a)(1). However, I fail to see how Liberty's reliance on an exception to section 203 rather than its inapplicability affects the construction of the statutory language therein. In other words, even if it can be proven that Liberty erroneously assumed that its partial tender offer was a "business combination," this assumption does not affect whether the tender offer is actually a business combination or not. That is for the Court to determine.

Plaintiffs next assert that the partial tender offer between Liberty and HSN's shareholders must necessarily "involve" HSN. Plaintiffs point to the dictionary definition of "involve" ("to include or concern"), and also note that under federal law the HSN board is required to publicly state its position with respect to the tender offer, as well as provide financial information to the SEC. *See, e.g.*, 17 C.F.R. §§ 240.13e-4, 240.14e-2 (assuming that plaintiffs can demonstrate that Liberty is an affiliate of HSN). Plaintiffs assume that because these federal regulations affect HSN regarding Liberty's partial tender offer, then the tender offer necessarily "involves" HSN. However, this information does not clarify the phrase "involving the corporation" for the Court. Rather, the phrase could be read as broadly as "touching and concerning any aspect" of the

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5. The offer to purchase states:

> [T]he Executive Committee of [HSN's] Board of Directors approved the transaction which resulted in Liberty becoming an "interested stockholder" of [HSN] (which action was ratified by the entire Board), thereby making the restrictions of Section 203 inapplicable to the further acquisition of [s]hares by Liberty . . . .

Rappaport Aff., Ex. A at 25.

corporation, or as narrowly as "making the corporation a party to" the business combination.

Because the term "involving" is not clear and unambiguous on its face, it is necessary to examine the underlying purpose of section 203. *Seigman v. Columbia Pictures Entertainment, Inc.*, Del. Ch., 576 A.2d 625, 634 (1989). *Seigman* also analyzed the legislative intent of section 203. As the Vice-Chancellor noted in *Seigman*, drafters' commentaries (of which there are two to section 203) provide the most legitimate sources of legislative intent. *Id.*

One source of drafters' commentaries is the synopsis, part of the official legislative history appended to any bill that is enacted into law, which states: "Section 203 is intended to strike a balance between the benefits of an unfettered market for corporate shares and the well documented and judicially recognized need to limit abusive takeover tactics." 66 *Del. Laws* ch. 204 (1988). The other source of commentaries is a report by two of the drafters, Goldman & McNally, *The Delaware Takeover Statute: A Report to the General Assembly*. It states:

> (1) The statute creates a balance between offeror on one hand and shareholder body on the other. . . . The stockholders are given bargaining strength through their board of directors who will negotiate for them in a takeover situation. The only way that stockholders can act effectively as a group to negotiate with an offeror is through their board of directors elected by them. They cannot take effective action independently or even as a group.
> (2) The statute prevents front-end-loaded, bust-up, two-step takeovers which on several occasions have been found to be coercive by the Delaware Supreme Court, and which have been specifically identified by the U.S. Supreme Court in the CTS decision as a problem to be dealt with by the States.

Goldman & McNally, *The Delaware Takeover Statute: A Report to the General Assembly* (1988), Executive Summary at § 4(b), *reprinted in* Craig B. Smith & Clark W. Furlow, *Guide to the Takeover Law of Delaware* (BNA Corporate Practice Series 1988) as Appendix P.

Furthermore, two commentators (one of whom was a drafter of the statute) have described section 203 as "[s]tructured to encourage negotiated acquisitions and fully priced tender offers, while discouraging highly leveraged, two-tier, front-end loaded, bust-up bids." Smith & Furlow, *Guide to the Takeover Law of Delaware*, at 3.

[8] It is clear that a tender offer is directed not at the target corporation, but at its shareholders. *See* Goldman & McNally, Executive Summary, at § 3 (Section 203 "*[d]oes not interfere with any right of an interested stockholder to make a tender offer directly to the stockholders*") (emphasis added); Sparks et al., "New Section 203 of the Delaware General Corporation Law: An Analysis," *reprinted in* Lawrence A. Hamermesh & R. Franklin Balotti, *The New Delaware Takeover Statute* 8, 15 (PLI 1988) ("It is important to note what the Act does *not* do. For example, "*[T]he Delaware Act: (a) does not prohibit tender offers or in any way regulate when, how, at what price or by whom they may be made*") (emphasis added). Therefore, the target corporation is not automatically "involved" in any tender offer for its shares. Unlike each of the other transactions defined as a "business combination" under the statute—merger, sale of assets, issuance or transfer of stock by the corporation, or receipt of financial benefits by the interested stockholder via the corporation—the corporation in the situation presented here is involved only *through* its shareholders. This interpretation comports with the basic understanding of the objectives of section 203. The primary purpose of the three-year waiting period on "business combinations" is to protect independent stockholders by precluding interested stockholders (acquirers) from using their equity positions to induce the (target) corporation into certain transactions. This purpose is not thwarted by virtue of a partial tender offer by an interested stockholder that has the effect (potentially) of increasing its interest from 23% to 40% of the corporation's equity.

Plaintiffs have not demonstrated that HSN is "involved" in the current partial tender offer. They have not demonstrated, at this juncture, any coercion by Liberty to induce the independent stockholders to tender their shares.[6] Furthermore, the plaintiffs have not shown any reason why the HSN board is better situated than the independent stockholders to decide whether to accept the $7 per share offer.

[9] Chancellor Allen has examined the conceptual difference between a merger and a tender offer regarding a board's historical power. He stated:

> This distinctive treatment of board power with respect to mergers and tender offers [is explained by] the conceptual

6. In fact, it appears that the offer is undersubscribed. *See* Letter to Vice Chancellor Chandler dated May 18, 1993, from Kevin Abrams, Esq.