Unreported Cases

INTRODUCTION

UNREPORTED CASES is a continuing feature of THE DELAWARE JOURNAL OF CORPORATE LAW. All unreported cases of a corporate nature that have not been published by a reporter system will be included. The court's opinions are printed in their entirety, exactly as received.

To expedite the attorney's research, all cases are headnoted according to the NATIONAL REPORTER key number classification system.* Indices are provided for case names, statutes construed, rules of court, and key numbers and classifications for this issue.

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AMERICAN HOECHST CORP. v. NUODEX, INC.

No. 7950

Court of Chancery of the State of Delaware, New Castle

April 23, 1985

Plaintiff, a maker of rigid gloss PVC products, sought an injunction to prevent a former employee from working for the defendant competitor on the basis that the employee possessed certain trade secrets which he would be unable to keep from revealing in the performance of his duties for the defendant. The court of chancery, per Vice-Chancellor Hartnett, held that although the plaintiff and defendant were competitors in the same business, their processes and products were sufficiently different to allow the employee to carry out his duties for the defendant without revealing any trade secrets owned by the plaintiff of which he may have knowledge.

1. Injunction ⇨ 132, 151

A preliminary injunction is an extraordinary remedy and the plaintiff bears the burden of showing a reasonable probability of success on the merits.

2. Injunction ⇨ 56, 128

Injunctions may issue in response to actual or threatened misappropriation. DEL. CODE ANN. tit. 6, § 2002(a) (1974).

3. Injunction ⇨ 128

Master and Servant ⇨ 60

Injunctions may be granted to protect former employers when an employee has taken a job with a competitor, and the employee's duties for the competitor require that he disclose and make use of trade secrets of the former employer, regardless of the employee's intent not to disclose or make use of the trade secret.

Rudolf E. Hutz, Esquire, of Connolly, Bove, Lodge & Hutz, Wilmington, Delaware, for plaintiff.

Richard D. Allen, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for defendant Nuodex Corporation.

James T. Vaughn, Jr., Esquire, of Vaughn & Vaughn, Dover, Delaware, for defendant Zane Q. Robinson.

HARNETT, *Vice-Chancelor*

Plaintiff American Hoechst Corporation seeks to enjoin a former employee-Zane Q. Robinson ("Mr. Robinson")—from continuing to work for Nuodex, Inc. ("Nuodex"). Both plaintiff and Nuodex produce rigid polyvinyl chloride ("PVC") film. Plaintiff claims that Mr. Robinson possesses trade secrets gleaned from his experience as a Calendering Department Supervisor at plaintiff's Delaware City, Delaware, plant. It is claimed that these trade secrets will inevitably be passed on to Nuodex if Mr. Robinson is allowed to remain as Production Manager at Nuodex's Edison, New Jersey, plant. Mr. Robinson and Nuodex deny that any of Mr. Robinson's knowledge constitutes trade secrets and also claim that even if Mr. Robinson does possess any of plaintiff's trade secrets, he does not intend, and will not be required, to disclose or to apply any of them in his work for Nuodex.

I find that plaintiff has not borne its burden of showing the reasonable probability that it has any trade secrets relating to matte PVC film which are known by Mr. Robinson or that Mr. Robinson, even if he knows of such trade secrets, is likely to divulge them to Nuodex. It therefore has not met the extraordinary burden necessary to warrant the imposition of a preliminary injunction and its application for injunctive relief is denied.

I

Rigid PVC film has numerous commercial and industrial uses. Among its uses are packaging for merchandise, covers for floppy discs ("diskettes"), and printed credit cards. It can be made in various thicknesses and with either a gloss or matte (dull) surface. Nuodex presently manufactures only matte film although it has the equipment to manufacture gloss film and imports and distributes gloss films manufactured by a Japanese firm. Plaintiff's Delaware City plant produces gloss film and embossed matte-gloss film. Plaintiff's Ottawa, Illinois, plant produces conventional matte film.

Mr. Robinson is a high school graduate who was employed as an automobile mechanic before 1965 when he began employment with Stauffer/Hoechst Polymer Corporation—a predecessor of plaintiff. From 1965 to 1982 he was employed in the slitting department of the rigid PVC film production at plaintiff's Delaware City plant. The slitting department is separate from the actual production process and involves the cutting of the finished product into the desired lengths and widths. Mr. Robinson began as an hourly worker and

was subsequently promoted to foreman and then to supervisor of the slitting department.

In 1978 Mr. Robinson was temporarily assigned to plaintiff's plant in Sandusky, Ohio, which produced extruded high impact polystyrene used to make dairy and other containers. Around 1980 he made several trips to plaintiff's Ottawa, Illinois, plant in order to help to improve the slitting, central packaging, and reporting functions of that plant. In 1983 he visited plaintiff's parent plant in Germany to view a new technology and to determine if it could be applied in Delaware City.

Mr. Robinson became a Calendar Supervisor at the Delaware City plant in July of 1982. He continued in that job until January 1, 1984, when he was put on special assignment related to the conversion of certain equipment purchased by plaintiff from Nuodex. This assignment lasted until January 1, 1985, when he returned to his old position as Calendering Supervisor.

During the autumn of 1984, Mr. Robinson developed the impression that plaintiff no longer wished to retain him and he began to seek employment elsewhere. He contacted John F. Dellevigne—a former executive of plaintiff who had gone to work for Nuodex. Mr. Dellevigne informed him that there were no openings and suggested another company which might be hiring.

In January of 1985, Mr. Dellevigne contacted Mr. Robinson about a vacancy which had recently occurred as a Production Manager. After several conversations, during which various factors were discussed—including salary and Mr. Robinson's obligations under confidentiality agreements he had with plaintiff—Mr. Robinson was offered and accepted a job with Nuodex. He is to receive a base salary which is more than $8,000 per year greater than his salary with plaintiff. He will be responsible for all aspects of the production process of rigid PVC film—including calendering—at the New Jersey plant.

Mr. Robinson formally gave notice of his resignation from plaintiff and his intention to go to work for Nuodex on February 12, 1985. He claims that he had never made any secret of his intention to find alternate employment. On February 12, 1985, he was relieved of his duties with plaintiff. He was told that he could pick up his final paycheck on February 22, 1985, at which time his resignation would become effective. Mr. Robinson states that no attempt was made to talk him out of his decision to leave.

The complaint in this action was filed on February 21, 1985. A hearing on an application for a temporary restraining order was

heard the next day. That application was denied by my February 26, 1985, Opinion.

I I

[1] A preliminary injunction is an extraordinary remedy and plaintiff bears the burden of showing a reasonable probability of ultimate success on the merits. *Gimbel v. Signal Companies, Inc.*, Del. Ch., 316 A.2d 599 (1974), *aff'd.*, Del. Supr., 316 A.2d 619 (1974).

[2] *The Uniform Trade Secrets Act as set forth in 6 Del. C.*, Ch. 20, defines trade secret:

> "Trade secret" shall mean information, including a formula, pattern, compilation, program, device, method, technique or process, that:
>
> a. Derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use; and
>
> b. Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy. (63 *Del. Laws,* c. 218 § 1) 6 *Del. C.* § 2001(4).
>
> "Misappropriation" shall mean:
>
> a. Acquisition of a trade secret was acquired by improper means; or
>
> b. Disclosure or use of a trade secret of another without express or implied consent by a person who:
>
> 1. Used improper means to acquire knowledge of the trade secret; or
>
> 2. At the time of disclosure or use, knew or had reason to know that his knowledge of the trade was:
>
> A. derived from or through a person who had utilized improper means to acquire it;
>
> B. Acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use; or
>
> C. Derived from or through a person who owed a duty to the person seeking relief to maintain its secrecy or limit its use; or
>
> 3. Before a material change of his position, knew

> or had reason to know that it was a trade secret and that knowledge of it had been acquired by accident or mistake. 6 *Del. C.* § 2002(2).

Injunctions may issue in response to actual or threatened misappropriation. 6 *Del. C.* § 2002(a). The effect of the Uniform Trade Secrets Act is to displace "conflicting tort, restitutionary and other laws of this State pertaining to civil liability for misappropriation of a trade secret." 6 *Del. C.* § 2007(a). Its general purpose is to make the law with respect to trade secrets uniform among the states enacting it, and it should be applied and construed so as to effectuate that purpose. 6 *Del. C.* § 2008.

[3] Injunctions have been granted to protect former employers when an employee has taken a job with a competitor, the nature of which will demand that the employee disclose and use trade secrets of the former employer regardless of the employee's intent so to disclose or to make use of the trade secrets. See *E. I. duPont de Nemours & Co. v. American Potash & Chemical Corp.*, Del. Ch., 200 A.2d 428 (1964), *American Totalisator Co. v. Autotote Limited*, Del. Ch., C.A. #7268, Longobardi, V.C., (August 18, 1983), *Allis-Chalmers Mfg. Co. v. Continental Aviation Eng. Corp.*, E.D. Mich., 255 F. Supp. 645 (1966), and *Air Products and Chemicals, Inc. v. Johnson*, Pa. Super., 442 A.2d 1114 (1982).

III

Mr. Robinson does not contest the binding effect of a 1973 agreement which he entered into with plaintiff whereby he agreed not to disclose trade secrets or other confidential information. There is therefore no question that the provisions of 6 *Del. C.* § 2001(2)(b)(2)(B) would apply if trade secrets were disclosed by Mr. Robinson. Although denying that he possesses any such trade secrets of the plaintiff, he agrees that if he possesses any trade secrets he would be bound not to disclose them. He alleges that his job at Nuodex is so different than his job with plaintiff that no trade secret knowledge which he could have obtained from plaintiff would be of any use at his new job. He also asserts that he will not, in any event, disclose to Nuodex any trade secret belonging to plaintiff. On the other hand, plaintiff maintains that Mr. Robinson necessarily learned its trade secrets and that the requirements of Mr. Robinson's duties with Nuodex are such that he will be unable—no matter how well meaning and diligent—to refrain from disclosing plaintiff's trade secrets.

IV

There has been considerable discussion by the parties of the relevance of Mr. Dellevigne's defection to Nuodex sometime prior to Mr. Robinson's move there because plaintiff took no action to interfere with Mr. Dellevigne's employment by Nuodex. It is agreed that Mr. Dellevigne had a more comprehensive knowledge of plaintiff's confidential information than does Mr. Robinson. Plaintiff seeks to draw a distinction by pointing out that Mr. Dellevigne holds an executive position in which he can more easily refrain from disclosure of plaintiff's trade secrets. Mr. Robinson, on the other hand, will be directly responsible for instructing workers and foremen on techniques used in all phases of the production of rigid PVC film. He will therefore be unable, according to plaintiff, to prevent his disclosure of plaintiff's trade secrets when they could be used to solve a problem which has arisen in the production process.

Plaintiff also points to bonus plans under which Mr. Robinson is now working and his hopes of future promotion. These, they say, will cause Mr. Robinson to inevitably use every means at his disposal to better Nuodex's production process—including the disclosure and utilization of plaintiff's trade secrets. The rather voluminous record apparently does not disclose, however, whether Mr. Dellevigne is operating under a similar incentive. It seems likely that he is, however, and he would therefore have the same incentive to disclose plaintiff's trade secrets and a wider knowledge from which to extract them.

The most likely circumstances of Mr. Robinson's work which would cause him to disclose plaintiff's trade secrets is his on-the-scene work situation. He will have the responsibility of dealing with foremen or supervisors with production problems who will come directly to him for advice on the best means to remedy the difficulty. Plaintiff asserts that in this situation Mr. Robinson would be unable to separate his own ability to reason out and solve production problems from his knowledge of plaintiff's confidential methods of solving similar problems.

V

Plaintiff has asserted that defendants have conceded that Mr. Robinson knows plaintiff's trade secrets. It appears from the record, however, that defendants only acknowledge that plaintiff does possess some trade secrets. The defendants do not concede that Mr. Robinson

has knowledge of any of them. They furthermore assert that because of the differences between the production of gloss surface and matte surface PVC film, and between plaintiff's machinery and process and Nuodex's machinery and process, there will never be an occasion for Mr. Robinson to make use of any trade secret he might possess.

Plaintiff maintains that the only significant differences between the processes for making gloss and matte film is that the last set of rolls in the calendering process is chrome-plated and smooth when making gloss film, and patterned and rough when making matte film. Mr. Dellevigne on the other hand, in his second affidavit, stresses differences in each of the production steps. The formulations, or recipes, for the products appear to differ. Gloss film is generally lower priced so the raw material cost is more significant in arriving at a formulation. The only difference in blending, apparently, is that since matte film is often pigmented—while gloss is not—knowledge of color technology and adjustment is important. Gloss film is made at three to four times the rate of matte. Fluxing capacity and rate of speed must therefore be greater when producing gloss film. When producing matte film, consistency and uniformity of flux are the chief concerns. The maintenance of the calendar rolls is quite different and the rate of speed and temperature at which gloss calendering occurs are much higher than for matte film. The stripping process requires that different stripping rolls be used and a lower temperature for matte film than for gloss. Gloss film may be rapidly cooled—whereas matte products may not. Finished gloss film may be wound into a roll whereas matte film is generally stacked into sheets while awaiting final trimming.

Mr. Robinson testified that now that he has become involved in Nuodex's operations and viewed the production process used, he does not see any way that plaintiff's confidential technology could be applied to Nuodex's very different machinery.

V I

On the record before me, I find that plaintiff has not demonstrated a reasonable probability of ultimate success on the merits. From a review of the affidavit, deposition testimony, and the rest of the voluminous record, I am convinced that Mr. Robinson will have no occasion to use plaintiff's technology at Nuodex. Even if Mr. Robinson possesses some confidential information plaintiff has not shown that it has any trade secrets in the matte PVC film processing area and the possibility of a misappropriation of any trade

secrets is too remote to constitute a realistic threat. This is true at least as long as Mr. Robinson is employed only in making matte PVC film with Nuodex's present procedures.

VII

Plaintiff also suggests that Nuodex has equipment for the production of rigid gloss PVC film at its Edison, New Jersey, plant—although it is not presently in operation. It is also claimed that Nuodex is presently negotiating or has contractual relations with Japanese concerns which produce rigid gloss PVC film and that Nuodex is planning to return to the production of such gloss film.

Even if plaintiff is arguably correct, the danger would only exist if Nuodex returns to the production of rigid gloss PVC film and Mr. Robinson is involved in that production. I cannot, however, prohibit Mr. Robinson from working for Nuodex, even if plaintiff is correct, simply because Nuodex may, at some time in the future, return to the production of rigid PVC film.

It is undisputed that Mr. Robinson may not disclose any of plaintiff's trade secrets, but his present position with Nuodex will, I am convinced, not lead to any such disclosure. The application for a preliminary injunction is therefore denied. IT IS SO ORDERED.

BOTNEY v. TELEDYNE

No. 5786

Court of Chancery of the State of Delaware, New Castle

April 24, 1985

Shareholder Botney, the sole named plaintiff representative, informed the court that he wished to withdraw from this class action suit brought against Teledyne, Inc. for alleged breaches of fiduciary duty in regards to a stock buy-back plan initiated by the corporation.

Miriam Waitman and Benjamin Gaffin, two former shareholders, sought to intervene to represent the class and Teledyne objected.

The court of chancery, per Vice-Chancellor Hartnett, denied Mrs. Waitman's motion to intervene since her interest in the action was based upon a property interest that did not appear to exist and at best was made under the unsettled laws of a foreign jurisdiction.

The court granted the motion of Mr. Gaffin to intervene as of right under Chancery Court Rule 24(a)(2) since the withdrawal of Mr. Botney would result in a dismissal of the suit and the statute of limitations would bar class members from initiating another action. Further, the court found Mr. Gaffin to be a clearly interested party able to represent the class who, despite being a relatively quiet class, did apparently exist.

1. Parties ⟸ 9

In a class action suit, when the sole representative of the class is withdrawing, an intervenor must merely show a cognizable interest in the subject matter and need not show that his interest is not being adequately represented by another. DEL. CH. CT. R. 24(a)(2).

2. Parties ⟸ 40(1)

In a class action suit, a dismissal and the bar of the statute of limitations would be a disposition which would impair or impede the ability of the person seeking intervention to protect his interest.

3. Parties ⟸ 40(2)

A motion to intervene should not be granted under Delaware Chancery Court Rule 24(a)(2) when the proposed intervenor's interest is based on a claim made under the unsettled law of a foreign jurisdiction. DEL. CH. CT. R. 24(a)(2).

4. Parties ⟸ 10

In a motion to intervene as a class action plaintiff, intervention should only be granted to one who is likely to meet the Rule 23(a)(4) requirement of fairly and adequately representing the class. DEL. CH. CT. R. 23(a)(4).

Thomas Herlihy, III, Esquire, of Herlihy & Wier, Wilmington, Delaware, for plaintiff.

Martin P. Tully, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for defendant.

Hartnett, *Vice-Chancellor*

This long pending suit is a purported class action which was brought in 1979 on behalf of former shareholders of Teledyne, Inc. ("Teledyne") who participated in a stock buy-back plan initiated by the corporation. Breaches of fiduciary duty involving unfairness of price and failure to disclose germane information are alleged. The named plaintiff, Allen E. Botney, informed the Court that he wished to withdraw from this action—both individually and representatively. Notice was sent to the shareholders who had sold stock under the buy-back plan to inform them of the pendency of this action and its possible dismissal. Two former shareholders came forward to seek to intervene in this action and to undertake the representation of the class. The motion of Miriam Waitman to intervene is denied because it appears that she was not a stockholder at the time of the transaction. The motion of Benjamin Gaffin to intervene is granted.

I

In 1969 Teledyne had approximately 37 million common shares of stock outstanding. By means of offers to purchase, exchange offers, redemption, and purchases on the open market, the number of common shares outstanding by the end of 1973 was less than 27 million shares and less than 14 million by the end of 1975.

This suit challenges an Offer to Purchase Shares of Common Stock of Teledyne, Inc. ("Buy-Back") dated February 9, 1976, which Teledyne sent to its common shareholders. The offer by its terms expired on February 27, 1976. The two and one-half page offering statement offered $40 per share cash for up to one million shares. The offering statement also provided that if there was a tender of more than one million shares, the corporation reserved the right to purchase more than one million shares, or it could purchase the tendered shares on a pro-rata basis. Two and one-half million shares were purchased through the Buy-Back offer, including 1.1 million shares from the Teledyne Employee Pension Plan. Subsequent to the Buy-Back, Teledyne went to the open market and from May through November of 1976 purchased over 600,000 shares of Teledyne common at prices ranging from over $59 to over $74 per share.

The offering statement did not mention any plan to purchase additional shares of stock in the future, nor was the record of past purchases mentioned. The offering statement merely gave the terms of the offer and a short history of the high and low prices of the stock on the New York Stock Exchange from 1973 through February 5, 1976.

It is alleged by the plaintiffs that on January 29, 1976, independent auditors certified Teledyne's 1975 financial results and that a press release concerning these results was made that same day. Teledyne's Annual Report was not, however, distributed until February 18, 1976—apparently the day after the deadline for withdrawal of shares tendered pursuant to the Buy-Back.

This is the fourth action brought challenging the Buy-Back. Three other actions were brought in U. S. District Courts. One was dismissed for failure to prosecute, another was voluntarily dismissed by the plaintiff, and the third resulted in a judgment for defendants and a denial of class action certification. None of the suits were dismissed on the merits, however. The controversy thereupon moved to this Court.

In 1981 Mr. Botney sought to withdraw as the named plaintiff in this suit citing the cost of the litigation in comparison to his proportionately small financial interest because he tendered only ten shares in response to the Buy-Back offer. He also cited a fear that defendant would employ pressure tactics against him. Notice of Mr. Botney's intended withdrawal was sent in 1983 to all shareholders who had tendered their shares under the 1976 Buy-Back offer. Two such persons have come forward and seek to intervene as plaintiffs in this action. The two persons are Miriam Waitman and Benjamin Gaffin. Mrs. Waitman tendered 15 shares in response to the Buy-Back offer which was held in her name as "Custodian for Deborah Waitman [her daughter] a Minor under the California Uniform Gifts to Minors Act". Mr. Gaffin tendered 4,974 shares held in his own name. Teledyne objects to the intervention.

Mrs. Waitman's daughter, Deborah, was over 21 years of age by the time the Waitman shares were tendered, and defendant Teledyne claims that the shares were not under the custodianship of Mrs. Waitman at the time of the tender. Mrs. Waitman allegedly had no right to tender them and, therefore has no standing to bring this action. As to Mr. Gaffin, it is alleged that he does not have the necessary motivation to represent the class and that he should consequently only be allowed to intervene individually.

Mrs. Waitman now requests that her motion to intervene be denied without prejudice. She cites the likelihood that no claimant with a small interest can prosecute the action because of the cost involved. She relies on Mr. Gaffin's coming forward to represent the class—including herself.

Mr. Gaffin still seeks to intervene and to carry on the action—both individually and representatively.

I I

[1,2] Chancery Court Rule 24(a)(2) permits intervention as of right:

> "when the applicant claims an interest relating to the property or transaction which is the subject of the action and he is so situated that the disposition of the action may as a practical matter impair or impede his ability to protect that interest, unless the applicant's interest is adequately represented by existing parties."

In a class action suit such as this wherein Mr. Botney, the sole representative of the class, is withdrawing, an intervenor must merely show a cognizable interest in the subject matter and need not show that his interest is not being adequately represented by another. This is so because if the intervention is not allowed this suit will be dismissed as a result of Mr. Botney's withdrawal and the class members will, undoubtedly, be barred from bringing another action because of the statute of limitations. A dismissal and the bar of the statute of limitations would be a disposition which would impair or impede the ability of the person seeking intervention to protect his interest.

I I I

Teledyne claims that Miriam Waitman should not be allowed to intervene because she does not have the requisite interest in the subject matter. It is conceded she never owned stock of Teledyne in her own name and at the time of the tender offer she was no longer legal custodian for her daughter's shares because her daughter had long since obtained her majority.

[3,4] These facts were brought out at Mrs. Waitman's deposition. After conferring with counsel off the record, she continued with her deposition and claimed that one-half of the shares in question

were purchased for her daughter and the other half were to be for herself. Teledyne asserts that intent is unimportant, so long as the required language is used, under the California Uniform Gifts to Minors Act.

In *Tanzer, et al v. Cavanham, Ltd., et al,* Del. Ch., C.A. No. 5349, Brown, V.C. (March 2, 1982), 7 Del. J. Corp. Law 513, it was held that intervention should not be allowed under Rule 24(a)(2) when the proposed intervenor's interest in the suit is based on a claim made under the unsettled law of a foreign jurisdiction. The then Vice Chancellor went on to state that intervention as a class action plaintiff should only be allowed to one who is likely to meet the Rule 23(a)(4) requirement of fairly and adequately representing the class. This was stated to ensure less cause for further delay when class certification would later come before the Court.

Obviously, this Court must be interested in judicial economy. It is therefore imperative that it not leave open questions concerning the adequacy of class representation. Mrs. Waitman's right to intervene is based upon an asserted property interest which appears on the record not to exist and, at best, is enmeshed in tangled web of factual allegations and California law. In any event, Mrs. Waitman now concurs that her motion to intervene should be denied. Mrs. Waitman's motion to intervene is, therefore, denied. IT IS SO ORDERED.

I V

Teledyne apparently does not dispute the existence of the requisite interest on Mr. Gaffin's part. Teledyne does assert that he should only be allowed to intervene individually and not as a representative of the class. It is asserted that Mr. Gaffin's interest in individually settling his claim and his lack of knowledge as to his potential liability for costs of the class action disqualify him as a class plaintiff and that he should therefore be allowed only to intervene individually.

At his deposition Mr. Gaffin expressed interest when he was told by counsel for Teledyne that he could seek settlement of his claim individually. He also stated that he understood his likely costs in the action to be for mailing notice to the class at $.35 for each of 5,000 notices. Teledyne's counsel informed Mr. Gaffin that the likely cost of taking this action to trial was in the area of $20,000 to $25,000—or even more.

Mr. Gaffin's deposition was taken in February of 1984. Since that time he has reviewed it in order to correct and to sign the original transcript. He also has had an opportunity to read and to review, with an attorney other than the counsel serving as attorney for the class, Teledyne's opening brief in opposition to his motion to intervene. This brief reiterates the possible costs of the litigation and Mr. Gaffin's fiduciary duty to the class if he is allowed to intervene as a class representative. Mr. Gaffin still desires to intervene on behalf of the class and not only individually, as he made clear in his hand—written letter to counsel in December of 1984.

In the brief in support of Mr. Gaffin's motion to intervene it is asserted that Mr. Gaffin's deposition testimony was correct as to the costs in this litigation. If he pursues this claim individually he will still have to pay discovery costs, expert witness fees, etc. The main difference in the class action format is that he will have to pay for printing and mailing of notice to the class.

Mr. Gaffin has a substantial interest in this litigation. He tendered almost 5,000 shares. Counsel for Teledyne has insinuated that if he abandons the class and intervenes individually Teledyne might well be willing to settle his claim. He also should now have a fairly clear understanding of his possible liability for costs in this action whether carried forward individually or on behalf of the class as well. He still wishes, however, to represent the class as well as himself.

Mr. Gaffin is quite clearly the sort of interested party who can fairly and adequately represent the class. He is willing to forego the possibility of a quick settlement of his individual claim and to take on the added expenses of pursuing this litigation as a class action.

Teledyne, however, also stresses the lack of shareholders coming forth to intervene and suggests that this demonstrates that the class does not really exist as a group who feel that they have been wronged. See *Kas v. Financial General Bankshares,* D.D.C., C.A. 82-1996, Johnson, J. (March 7, 1985) cited in an April 16, 1985 letter of Teledyne. In light of this, it is suggested that there would be no injury to the expectations of the class if Mr. Gaffin were not allowed to intervene individually.

Many members of the punitive class, however, may have tendered only a few shares and may therefore be unwilling to take on the costs of litigation such as this. Others may have been put off by the history of this litigation, Teledyne's obviously zealous defense, or the remoteness in time of the alleged injury. The fact that only two potential intervenors came forward does not require that Mr.

Gaffin be denied the opportunity to intervene for the class. Although the class may be relatively quiet, it apparently does exist, and there may be numerous former stockholders who hope something will come of this suit but who are unwilling or unable to undertake its prosecution themselves. Mr. Gaffin has offered to represent these people and to bear the costs of the litigation. He has the requisite interest, and he will be permitted to intervene—both individually and on behalf of the class. IT IS SO ORDERED.

CARPENTER v. TEXAS AIR CORP.

No. 7976

Court of Chancery of the State of Delaware, New Castle

April 18, 1985

Plaintiffs, shareholders of Texas Air and members of the Airline Pilots' Association International Union, seek to inspect the list of stockholders of Texas Air. Plaintiffs allege that the purpose for this request is to communicate with the shareholders concerning issues related to the corporation's management and affairs, and to its relationship with Continental Airlines. The Pilots' Union is currently striking Continental for more generous employment terms. Texas Air refused to allow inspection of its shareholders list, alleging that plaintiffs' purpose for inspection was improper. Plaintiffs sent a supplemental letter requesting inspection of stockholders list for the purpose of soliciting proxies. Texas Air claims that the original demand and the supplemental letter were insufficient and should, therefore, be denied.

The court of chancery, per Vice-Chancellor Hartnett, held that plaintiffs' request to inspect the stockholders list was not for a purpose reasonably related to their status as stockholders. The real party in interest is the Pilots' Union, who initiated the suit in order to put economic pressure on Continental Airlines, Inc., plaintiffs' real interest in this case. The court found this to be an improper purpose,

and the demand made by the plaintiffs insufficient and, therefore, denied plaintiffs' request.

1. Corporations ⟸ 181(1)

Shareholder's demand to inspect the list of shareholders for the primary purpose of soliciting their proxies constitutes a proper purpose. DEL. CODE ANN. tit. 8, § 220 (1953).

2. Corporations ⟸ 181(1)

Once a shareholder establishes a primary purpose for demanding to inspect a list of the shareholders, any secondary purpose or motive, which may be improper, is irrelevant. DEL. CODE ANN. tit. 8, § 220 (1953).

3. Corporations ⟸ 181(5)

A shareholder, making a demand to inspect the list of shareholders, must state the substance of his intended communication in a manner sufficient to allow the corporation and the courts to determine whether there is a reasonable relationship between his purpose and his interest as a shareholder. DEL. CODE ANN. tit. 8, § 220 (1953).

4. Corporations ⟸ 181(5)

Demand by shareholder seeking a list of shareholders, stated purpose of which was to solicit proxies, may be given an expanded reading when related to an impending stockholders meeting. DEL. CODE. ANN. tit. 8, § 220 (1953).

5. Corporations ⟸ 181(8)

Any technical defect in a shareholder's demand to inspect a corporation's books and records may be cured at trial.

6. Corporations ⟸ 181(8)

When a technical defect exists in a shareholder's demand to inspect a corporation's books and records, the burden of persuasion to cure the technical defect at trial is upon the plaintiff.

7. Corporations ⇐ 181(8)

Once a shareholder has properly made out a demand in the form and manner as required by statute, the burden of proof to establish that the purpose of the demand is improper shifts to the corporation. DEL. CODE ANN. tit. 8, § 220 (1953).

Arthur G. Connolly, Jr., Esquire, and Collins J. Seitz, Jr., Esquire, of Connolly, Bove, Lodge & Hutz, Wilmington, Delaware, for plaintiffs.

Paul P. Welsh, Esquire, and Donald E. Reid, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for defendant.

HARTNETT, *Vice-Chancellor*

Plaintiffs are shareholders of Texas Air Corporation, a Delaware corporation, ("Texas Air") and seek to inspect the list of shareholders pursuant to 8 *Del. C.* § 220. Texas Air has refused to allow inspection of the stocklist asserting that plaintiffs have not made a proper demand and that plaintiffs' true purpose is an improper purpose. After trial, I find from the unusual procedural and factual circumstances of this case that plaintiffs' request to inspect the stocklist must be denied.

I

It is clear from the facts adduced at trial that the real interest of plaintiffs concerns Continental Air Lines, Inc. ("Continental") and plaintiffs' interest in Texas Air is only because of its relationship with Continental. Texas Air owns the majority of the stock of Continental Airlines Corporation which owns all of the outstanding stock of Continental. Both Continentals and certain affiliates, not including Texas Air, filed voluntary Chapter 11 Bankruptcy petitions on September 24, 1983 in the United States Bankruptcy Court for the Southern District of Texas, Houston Division ("Bankruptcy Court"). Continental had operated the 8th largest passenger airline in the United States and had net losses of over $500 million since the airline industry was deregulated in 1978.

After filing the Chapter 11 petition, Continental was shut down briefly. It then reopened but attempted to operate on a more austere basis. Continental was permitted by the Bankruptcy Court to terminate its pre-petition collective bargaining agreements. It then of-

fered its pilots, as well as other employees, less generous employment terms. Some pilots found this acceptable. The Airline Pilots' Association International ("ALPA"), the pilots' union, however, rejected the new terms and, on October 1, 1983, went on strike.

Continental has been able to operate despite this strike and had a net profit of over $50 million for the year ending on December 31, 1984.

Plaintiff-Taylor is a former pilot of Continental who is a member of ALPA and plaintiff-Carpenter was a pilot of Continental and a member of ALPA until he reached the mandatory retirement age for pilots and retired on February 1, 1985. Both have taken an active role in the strike.

The strike has been a long and bitter one. ALPA has been extremely vocal and has managed to initiate Congressional Inquiry into the safety of Continental's continued operations. ALPA has also organized rallies or picketing at the places of business of three of Continental's outside directors and, apparently, has a program of action to encourage pilots to quit flying for Continental, to create a financial drain on Continental, and to publicize Continental as unsafe. ALPA has also undertaken a vigorous media campaign urging passengers not to fly Continental because of alleged safety deficiencies and for other reasons.

In June of 1984, ALPA solicited for pilots who owned stock in Texas Air. Plaintiffs apparently came forward at that time or at the time of an earlier solicitation. Resolutions were then submitted in their names to the Board of Texas Air with a request that two resolutions be submitted to the stockholders for adoption. The resolution submitted in Mr. Taylor's name would require the corporation to submit to its stockholders an annual report as to Texas Air's potential liability for any accidents involving Continental due to a lack of safety. Mr. Carpenter's resolution seeks to involve the stockholders in fare setting policies of Continental. Both resolutions, on their face, do not seem to be the type of resolutions which would be the subject of a bonafide proxy campaign.

A letter under oath dated February 6, 1985, and denoted as "DEMAND FOR OPPORTUNITY TO INSPECT CORPORATE STOCK LEDGER" was sent to Texas Air by Ronald G. Kurtz, the agent of the plaintiffs. The purpose of the inspection was to allow preparation of a list of shareholders so that the plaintiffs could "communicate with these stockholders regarding issues concerning the Company's affairs and its management and operations, including the Company's relationship with Continental Airlines Corporation, a Delaware corporation that filed a petition in bankruptcy on Sep-

tember 24, 1983. " Texas Air took the position that the letter did not state a proper purpose. A letter dated March 28, 1985—but not under oath—was sent by Mr. Kurtz as a "supplemental demand letter" and stated that the stocklist was necessary so that plaintiffs could solicit proxies in favor of passage of the two resolutions.

The Securities Exchange Commission has apparently refused to require that the materials of the plaintiffs be sent along with Texas Air's annual proxy materials. That decision is currently under appeal. Texas Air, however, seemed to indicate in its pre-trial brief that it was willing to send out plaintiffs' materials with its own proxy solicitations. This offer was not repeated at trial, however. Even if Texas Air agreed to do this, however, defendants do not find this arrangement satisfactory because one of them states that he may wish to contact shareholders directly by phone and they also do not wish their proxy to arrive with the materials of the corporation. The annual meeting of Texas Air will take place at an unannounced date during the month of May.

I I

[1,2] Plaintiffs contend that they have made a demand which is sufficient under 8 *Del. C.* § 220. Their primary purpose is claimed to be to solicit proxies which is, of course, a proper purpose. *Kerkorian v. Western Airlines, Inc.*, Del. Ch., 253 A.2d 221 (1969), *aff'd.*, Del. Supr., 254 A.2d 240 (1969). They correctly assert that once a primary purpose is properly established, secondary motives which may be improper are irrelevant. *C M & M Group, Inc. v. Carroll,* Del. Supr., 453 A.2d 788 (1982).

Texas Air, however, contends that the demand was insufficient when made and has been improperly supplemented and that, therefore, the complaint fails to state a claim upon which relief can be granted and should be dismissed. Texas Air also contends that plaintiffs' primary purpose for inspection of the stock ledger is to obtain a list of stockholders so that economic pressure can be exerted upon Continental by ALPA. Such a purpose is argued to be improper as it is not related to plaintiffs' interest as shareholders of Texas Air but rather is related to ALPA's interest as a partisan in a strike against Continental.

I I I

[3,4] A shareholder making a demand under 8 *Del. C.* § 220 must state the substance of his intended communication in a manner

sufficient to allow the corporation, and the courts, to determine whether there is a reasonable relationship between his purpose and his interest as a shareholder. *Northwest Industries, Inc. v. B. F. Goodrich Company,* Del. Supr., 260 A.2d 428 (1969). The demand may, however, be given an expanded reading when viewed in light of surrounding circumstances, "such as an impending stockholders' meeting". *Weisman v. Western Pacific Industries, Inc.,* Del. Ch., 344 A.2d 267 (1975).

[5,6] It is also possible to cure any technical defect in the wording of the demand at trial. *Henshaw v. American Cement Corp.,* Del. Ch., 252 A.2d 125 (1969); *Devon v. Pantry Pride, Inc.,* Del. Ch., C.A. #7843, Hartnett, V.C. (November 21, 1984); *Odyssey Partners v. Trans World Corp.,* Del. Ch., C.A. #7125, Hartnett, V.C. (March 29, 1983); *Hatleigh Corp. v. Lane Bryant, Inc.,* Del. Ch., C.A. #6318, Hartnett, V.C. (February 5, 1981). The burden of persuasion to cure a technical defect at trial is, however, upon a plaintiff.

The initial demand of the plaintiffs was defective because it lacked the requisite specificity. *Northwest Industries, Inc. v. B.F. Goodrich Company, supra; Weisman v. Western Pacific Industries, Inc., supra.* The supplemental demand did not cure the deficiency because it was not under oath as is required by the statute.

Although plaintiffs could have cured the defect at trial under the rule of law set forth in *Henshaw v. American Cement Corp., supra,* they did not because the plaintiffs' testimony at trial clearly established that they do not really desire to communicate with the stockholders of Texas Air for a purpose reasonably related to their stock holdings in Texas Air. It is abundantly clear from the entire record that they did not really initiate this action and that plaintiffs' participation in this action is merely a sham. This suit was initiated by ALPA and it solicited its members owning Texas Air stock to come forward in order to enable it to find a method of bringing this action. ALPA had all the resolutions drawn up and the plaintiffs signed them having admittedly been in no way involved in their drafting. The same apparently is true of the original and supplemental demand letters. I also find that none of the costs are being paid by plaintiffs but are being underwritten by ALPA and that ALPA's sole interest is attempting to find ways to exert economic pressure on Continental. I also find that plaintiffs' real interest, like that of ALPA, is to bring economic pressure on Continental in connection with the strike.

Plaintiffs correctly claim that once a proper purpose for solicitation of proxies has been established, all other purposes are secondary and should not be considered by the Court. It is clear, however, that the real party in interest is ALPA and there was no evidence

whatsoever introduced by plaintiffs as to its purpose in seeking a stocklist. Plaintiffs' original demand for a stocklist did not sufficiently state the substance of their intended communications, their supplementary letter must be disregarded, and the evidence at trial fell far short of what is required to cure the deficiency. The demand for a stocklist for that reason alone must be denied.

IV

[7] Once a stockholder has properly complied with the provisions of 8 *Del. C.* § 220 respecting the form and manner of making a demand, the burden of proof to establish that the purpose is improper shifts to the corporation. 8 *Del. C.* § 220(c); *Hatleigh Corp. v. Lane Bryant, Inc., supra.*

As I have held, the plaintiffs did not properly comply with the provisions of 8 *Del. C.* § 220 in that their form of demand was deficient and they did not cure the deficiency at trial because they did not show that they seek the list for a proper purpose.

Even if plaintiffs' demand could be held to have been proper, and even if the plaintiffs were the real parties in interest, it is clear from the entire record at the trial that the respondents have borne their burden of establishing that the purpose for the demand is improper.

It is clear from the entire record that ALPA, which is the real party in interest, is intent upon inflicting economic pressure upon Continental in order to force it to accede to ALPA's demands. And it is clear that ALPA will use whatever legal means it can to obtain that result. I have no doubt, from reviewing all the evidence, that ALPA and the plaintiffs are not really interested in obtaining a stocklist to communicate with the stockholders of Texas Air about the forthcoming annual meeting, but rather desire it in furtherance of a plan to bring economic pressure on Continental. This is not a purpose reasonably related to a stockholders' interest in the corporation from which a stockholder list is sought. *Weisman v. Western Pacific Industries, Inc., supra; State ex rel Theile v. Cities Serv. Co.*, Del. Supr., 115 A. 773 (1922); *State ex rel Linihan v. United Brokerage Co.*, Del. Supr., 101 A. 433 (1917); *General Time Corp. v. Talley Indus., Inc.*, Del. Ch., 240 A.2d 755 (1968).

V

This Court is always reluctant to deny a stockholder's request to inspect a stocklist. It is an unusual case, indeed, where a stock-

holder's demand to inspect a list of stockholders in connection with a pending annual meeting is denied. The facts here, however, provide the exception to the general rule.

Needless to say, a labor organization which is a stockholder can, under proper conditions, obtain the necessary means to communicate with its fellow stockholders for a proper purpose and in a proper manner. This is not the situation here, however.

The plaintiffs' demand for a stocklist is denied. IT IS SO ORDERED.

COOK V. PUMPELLY

Nos. 7917 & 7930

Court of Chancery of the State of Delaware, New Castle

May 24, 1985

Declaratory action involving issue as to the votability of escrowed shares and the ability of one co-owner to vote all jointly owned shares, in determining whether fifty percent of the outstanding stock of a corporation had voted in favor of a new board of directors.

The court of chancery, per Vice-Chancellor Berger, held that in applying the voting rules of DEL. CODE ANN., tit. 8, § 217, to a consent under DEL. CODE ANN. tit. 8, § 228 only the co-owner's proportionate interest in jointly owned shares would be counted toward a majority. In this way the excluded co-owner is in the same position he would have been in if there had been a vote and he opposed the action. The court further held that stocks delivered into escrow were not "delivered" for purposes of entitling plaintiff to vote such stock. Lastly, the court held that early release of the escrowed shares by one of the board members, before fulfillment of plaintiff's employment contract, was a modification of the consideration for the issuance of the shares and by statute, that function lies with the entire board and cannot be delegated to one board member.

1. Statutes ⟸ 239

The rule that statutes in derogation of the common law will be strictly construed is not applied in all cases and should not be used to restrict the effectiveness of the statute.

2. Statutes ⟸ 206

An interpretation which applies the voting rules of DEL. CODE ANN. tit. 8, § 217 to a consent under DEL. CODE ANN. tit. 8, § 228 would appear to give more complete effect to the purpose of both statutes.

3. Corporations ⟸ 197

Common stock held in escrow cannot be "delivered" for purposes of entitling plaintiff to vote such stock until custody and control of the stock certificates passed to plaintiff.

4. Corporations ⟸ 99(2)

The board of directors is required to determine the consideration for which shares are to be issued and any modification of that consideration lies with the entire board and cannot be delegated to one board member.

Edward B. Maxwell II, Esquire, of Young, Conaway, Stargatt & Taylor, Wilmington, Delaware, for plaintiff Cook.

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

Donald J. Wolfe, Jr., Esquire, of Potter, Anderson & Corroon, Wilmington, Delaware, for defendant NTW.

BERGER, *Vice-Chancellor*

This is the decision after trial in an action pursuant to 8 *Del. C.* § 225 to determine the lawful composition of the board of directors of NTW, Incorporated ("NTW"), a Delaware corporation. Plaintiffs, G. Bradford Cook ("Cook") and Richard Strother ("Strother") (collectively the "Cook group"), filed their complaint on January 17, 1985 seeking a declaration that Cook, Strother, Robert W.

Dudley, Kenneth M. Crosby and defendants Thomas F. Pumpelly ("Tom Pumpelly") and his brother, John Reed Pumpelly ("Reed Pumpelly") constitute the six validly elected directors of NTW. Following a shareholders meeting held on January 18, 1985, purporting to change the composition of the NTW board of directors, an amended complaint was filed on February 5, 1985.

Also on February 5, the Pumpelly brothers filed a § 225 action alleging that prior to January 18, 1985 they and Gary Gross constituted the NTW board of directors and since that time the board consisted of Tom Pumpelly, David Bell, Kenneth Rice and Maurice Whelan. The Pumpelly complaint alleges that a consent executed on November 21, 1984 which purported to install the Cook group board of directors as well as other agreements executed on the same date are invalid, having been obtained through fraud. The two actions were consolidated and trial on these "summary" proceedings ran for five days, ending on March 22, 1985. Post-trial briefing was concluded one month later.

NTW, the largest independent tire retailer in the United States, was founded by the Pumpelly brothers in 1971. Tom was President of the corporation and Reed was Secretary/Treasurer. Both brothers served as directors along with David Bell ("Bell"), NTW's Chief Financial Officer. Sometime prior to November 21, 1984, Bell resigned from the board and was replaced by Gary Gross.

The company expanded rapidly, selling franchises throughout the country. However, in the fall of 1983, NTW began to experience cash flow problems as several under-capitalized franchises failed. Bell and the Pumpelly brothers considered making a private placement of some of NTW's stock as a means of raising capital. They were introduced to Strother through an investment banker consulted about the private placement. In discussions with Strother, the Pumpellys and Bell agreed that NTW should pursue a public offering rather than a private placement.

Strother agreed to work with NTW to prepare for a public offering. Under his employment contract, executed on February 29, 1984, Strother agreed to provide management and business services to NTW for 18 months and to devote not less than 400 hours per year to NTW. In return for his services, Strother was to be paid a salary of $122,000. In addition, the contract provided that Strother "hereby purchases 30 shares of common stock of NTW at $1.00 each. . . ." Those shares were required to be held in escrow until NTW successfully completed the first stage of its growth objectives. In the event that the first stage objective (obtained $8.5 million in

additional equity) was not met prior to July 1, 1985, or Strother failed to perform under the contract, the 30 shares were to revert to NTW. Strother paid for the shares, and a stock certificate (bearing no notations of any restrictions) was delivered to Keith Malley ("Malley"), NTW's in-house counsel, to be held in escrow pursuant to the contract.

By April, 1984, NTW's cash flow problems had worsened. It was apparent by then that there would be no public offering and Strother, who had become a close confidant of both of the Pumpellys, took on the more expanded role of overall business, financial and management consultant. Strother's original contract was modified to provide an additional payment of $2,166 per month in exchange for a total commitment to NTW of approximately 2 to 3 days per week.

NTW's financial situation continued to deteriorate through May, 1984. Strother was working full time for NTW and, because of the extent of his commitment, Strother testified that he approached Tom Pumpelly about an increase in salary. Strother says that although Tom was not willing to increase Strother's salary, he was willing to release the 30 shares from escrow immediately. Tom Pumpelly denied having made such an agreement in June, 1984 and the document purporting to release Strother's escrowed shares is dated August 10, 1984. Strother inserted a note at the bottom of the August 10 agreement stating "Agreement made June 3, 1984, executed 10 Aug. 84."

As part of his efforts to obtain funds for NTW, Strother arranged a meeting between the Pumpelly brothers and Cook to discuss Cook's willingness to invest in NTW. Cook indicated that he was not willing to invest capital at that time, but he offered his management skills which, he believed, would help turn NTW around. After that was accomplished, Cook said that he would consider a capital investment.

Following this meeting, Cook submitted a business plan dated June 1, 1984 which was promptly rejected by Tom Pumpelly. On June 27, 1984, Cook submitted a second business plan. However, on the following day NTW filed a petition for reorganization under Chapter 11 of the Bankruptcy Code. As a result, no attention was given to Cook's second business plan.

The bankruptcy proceedings added to the strain that had always existed between the Pumpelly brothers. In addition, Reed was concerned that he might face personal bankruptcy inasmuch as he had guaranteed several million dollars of corporate debt. He became convinced that a change of management would be necessary to ensure NTW's recovery.

At this time, the stock of NTW was held as follows: Tom and Reed Pumpelly each owned 384 shares individually plus an additional 120 shares which they owned jointly. Helen Pumpelly, Tom and Reed's stepmother, held 15 shares and Cynthia Spikell, the sister of Armand Spikell, a former employee of NTW, owned 28 shares. Strother's 30 shares still were being held by NTW's counsel although, as noted earlier, Strother maintains that those shares were released from escrow in June, 1984. If the Strother shares are excluded from the calculation as being in escrow and non-votable, the total number of shares outstanding was 931. Based upon these assumptions, Reed Pumpelly and Armand Spikell, who apparently was acting on behalf of his sister, would have controlled a majority of the NTW stock—Reed's 384 shares held individually plus 60 of the 120 shares he held jointly with his brother plus Cynthia Spikell's 28 shares. On the other hand, if Strother's 30 shares were eligible to be voted, he would have to join with Spikell and Reed Pumpelly to oust Tom Pumpelly.

Inasmuch as Reed Pumpelly was of the view that a shareholder vote would be required to replace Tom Pumpelly, he arranged a meeting in mid-July with Strother and Spikell to discuss the matter. They all agreed that something should be done although no plan was devised. Strother then suggested that Reed and Spikell meet with Cook to reconsider the possibility of Cook participating in the business. However, Spikell and Cook did not hit it off. Instead of setting up a new management team with Cook, Spikell suggested a man by the name of Stanley Scheinman ("Scheinman"), an attorney who had held senior management positions with several large national and international retail firms. Reed was in favor of bringing Scheinman into the company but Strother was opposed. As a result, Reed abandoned the idea explaining that he did not want to be fighting both his brother and Strother at the same time.

As the summer wore on, Reed's relationship with his brother continued to deteriorate and there appeared to Reed to be no solution in sight. By mid-September, Reed was so fed up that he asked Strother to find someone to buy him out for $1 million. On September 28, Strother conveyed what Reed thought was an offer from Cook whereby Cook would obtain a one year option to buy Reed's stock for $1 million after-tax net to Reed and control of Reed's stock during the year. Reed would receive a $100,000 option fee and certain personal guarantees and protections from potential liability.

Two days later, when Strother called Reed to find out his decision, Reed accepted the "offer." From Cook's perspective, how-

ever, only a general agreement as to the nature of the transaction had been reached as of September 30, 1984. Cook felt that the details of the parties' respective obligations would be subject to refinement by attorneys consistent with fiduciary obligations.

After Reed had accepted the "offer," Strother suggested that Reed obtain counsel to represent him in the transaction. Strother, by then, was a co-investor in the deal with Cook. Strother suggested J. Dapray Muir, Esquire ("Muir") and drove Reed to his first meeting with Muir the following week. Reed understood that Muir was being retained to draft and/or review the documents that would be necessary to implement what he believed was a firm agreement. However, over the next six weeks, the terms of the transaction were altered, largely at the insistence of the Cook group. As finally presented to Reed, the transaction involved (1) a stock purchase agreement for 15 shares of Reed's stock for $50,000; (2) an option agreement giving the Cook group as much as 5 1/2 years to purchase Reed's stock for a $100 option fee; (3) a voting trust agreement; and (4) a stock pooling agreement. The option agreement contained some but not all of the protections Reed had requested with respect to his release from guarantees of corporate indebtedness, his continued position and "perks" and certain of his potential liabilities to the company. Notwithstanding these modifications to what Reed originally thought was the agreement, he proceeded with the transaction.

On November 12, 1984, Shaw Bay, a Delaware corporation formed by Cook and Strother, purchased Helen Pumpelly's 15 shares for $50,000 and on November 21, 1984, Reed and the Cook group went to closing. The evidence is unclear as to the precise order in which the documents were executed inasmuch as they were all being passed around the table for signature at the same time. However, the following transactions took place:

> (1) Reed and Shaw Bay executed a stock purchase agreement whereby Reed sold 6 shares of his NTW stock for $20,000 and agreed to sell an additional 9 shares for $30,000 subject to certain conditions which were to be satisfied within 60 days after delivery of the stock certificates and the money to an escrow agent.
>
> (2) Reed and Shaw Bay entered into a voting trust agreement pursuant to which they agreed to transfer all of their shares of NTW (excluding Reed's jointly owned shares) to Cook, Reed, Strother and Crosby as trustees and to vote such shares at the direction of a majority of the trustees.

(3) Reed and Shaw Bay entered into a stock pooling agreement pursuant to which Reed agreed to exercise his voting rights in the 120 jointly owned shares as agreed by Reed and Shaw Bay. Absent agreement, Reed was required to vote those shares in the manner determined by a majority of the trustees of the voting trust.

(4) Reed executed an option agreement whereby he granted Shaw Bay an option to purchase all his remaining shares of NTW, including his interest in the jointly owned shares, for $1,297,000 subject to certain conditions.

(5) Strother delivered his 30 shares of NTW stock to Shaw Bay in exchange for 1500 shares of the common stock of Shaw Bay.

(6) Reed and Shaw Bay executed a written consent pursuant to 8 *Del. C.* § 228 whereby, among other things, the directors of NTW were removed without cause and replaced by Cook, Strother, the Pumpelly brothers, Kenneth Crosby and Robert Dudley. The consent purported to represent more than 50% of the 961 outstanding shares of NTW stock as follows: Reed's 378 shares owned individually, 60 of his jointly owned shares and Shaw Bay's 51 shares.

After all the documents were executed, the stock certificates were filled out. They had been previously executed by Reed Pumpelly, as Secretary/Treasurer, and Malley, as Vice President, and the corporate seal had been affixed to the otherwise blank certificates. Apparently, the parties believed that they had a sufficient number of executed stock certificates to effectuate a step transfer whereby six of Reed's 384 shares would be transferred to Shaw Bay and the remaining 378 shares would be transferred to Reed followed by transfers from Reed and Shaw Bay to the voting trustees. However, at the closing it was discovered that there were not enough executed stock certificates. As a result, Reed transferred his 378 remaining shares directly to the trustees.

On November 23 and 24, both Tom Pumpelly and Armand Spikell were asked to sign a consent but both refused. A copy of the consent was sent to Cynthia Spikell on November 27, 1984.

Tom Pumpelly responded to the events of November 21, 1984 promptly. On November 27, he called a meeting of the NTW board as constituted prior to the consent—Reed, Tom and Gary Gross. A resolution was adopted by Tom and Gary Gross issuing the 39

remaining authorized but unissued NTW shares to Tom in consideration for the reduction of NTW's outstanding indebtedness to Tom by $300,000.

At about the same time, Reed was threatened with the loss of his home. Title to his home was held by his stepmother, Helen Pumpelly, as a means of avoiding creditors. Although Reed and Helen Pumpelly had an understanding that title would be transferred to Reed as trustee for his daughter, that transfer had not been accomplished prior to November 21, 1984. The threat was an effort to force a reconciliation between the two brothers.

On December 2, 1984, Reed was provided additional information as to Cook's prior involvement in Watergate. A rumor had surfaced during the summer that Cook had been involved in Watergate, had been forced to resign as Chairman of the SEC and had been disbarred. However, Reed testified that Strother investigated the rumor and reported back to him that there was nothing to it. Strother maintains that he told Reed the little he had found out about Cook—that Cook had resigned from the SEC and had had something to do with Watergate. In any event, Reed never asked Strother about the extent of his investigation of the rumor and never asked Cook anything about it.

When the issue was raised again in early December, 1984, Reed was given a copy of a publication entitled "Facts on File" in which it was reported that Cook admitted lying to a federal grand jury and two congressional committees in connection with investigations of Robert Vesco and indictments ultimately handed down against former Attorney General John Mitchell and former Commerce Secretary Maurice Stans. "Facts on File" also reported that Cook resigned from the SEC because of circumstances linking him to charges of conspiracy to obstruct justice and perjury brought against Mitchell and Stans and that Cook had been suspended for three years from the practice of law by the Nebraska Supreme Court and was suspended from practicing before the United States Supreme Court.

Reed testified that he was shocked and dumbfounded by this information. He confronted Cook, who explained the events reported in "Facts on File." In an effort to reassure Reed that he need not be concerned about Cook's Watergate involvement, Cook provided Reed a list of ten reputable business men and attorneys as references. Cook also provided Reed a private office and a telephone with which to contact these people. Reed contacted most of the references and

was satisfied that Cook was highly regarded notwithstanding his activities of a decade before. Indeed, only a few days thereafter, Reed spoke up on Cook's behalf at a meeting of NTW employees.

By late December, 1984, Reed decided that he had made a mistake in joining forces with the Cook group. Reed explained his change of heart to Tom on Christmas day and by January 4, 1985 the Pumpelly brothers executed a reconciliation agreement. That agreement provided Reed with many of the assurances he had been looking for from the Cook transaction and included a provision that Reed would do anything reasonably requested by Tom, short of committing a crime, in order to revest control and ownership of NTW in the two brothers. Reed then met with Cook and revoked his consent, rescinded the voting trust and stock pooling agreements on the grounds of fraud and rescinded the option contract for breach since the $100 option fee had never been paid.

Tom and Reed called a shareholders meeting on January 18, 1985. Three actions were purportedly taken at the meeting by majority vote: (1) all existing directors were removed and replaced with a new board consisting of Tom, Bell, Maurice Whelan and Kenneth Rice; (2) the issuance of 30 shares of stock to Strother was rescinded; and (3) the issuance of 39 shares to Tom was ratified. Tom voted 571 shares in favor of the three proposals. Included in his vote were the 384 shares he owned individually, the 39 shares issued on November 27, 1984, 28 shares he had purchased from Cynthia Spikell and all of the 120 jointly owned shares. Reed attended the meeting but did not vote. He refused to take any action with regard to the voting trust or the pooling agreement and he refused to confer with the trustees. The trustees cast 549 votes against the three proposals—the 429 shares registered in their names and all of the 120 jointly owned shares. Thus, a total of 1120 votes were counted although only 1,000 shares were outstanding.

Finally, while discovery in this litigation was underway, the Pumpelly brothers executed a consent, purporting to represent the holders of a majority of the outstanding shares of NTW, whereby the directors were again removed and replaced by Tom, Bell, Patrick King and Maurice J. Whelan.

The first issue to be resolved is whether the November 21, 1984 consent was signed by the holders of more than 50% of the outstanding shares of NTW entitled to vote. 8 *Del. C.* § 228. The Cook group argues that this requirement was satisfied either (1) by counting Reed's consent for the jointly held shares as representing 60 shares and including Strother's 30 shares in the calculation or (2) by counting

Reed's consent for the jointly held shares as representing all 120 shares if, for any reason, Strother's 30 shares are not included in the calculation. The Pumpellys contend that Reed had no authority to exercise a consent for any of the jointly held shares and that Strother's 30 shares were never validly released from escrow, were not entitled to vote and, therefore, could not be included in the consent.

The interaction of 8 *Del. C.* § 217, governing the voting rights of joint owners of stock and 8 *Del. C.* § 228, the consent statute, apparently has never been considered by our courts. Section 217 provides, in pertinent part:

> (b) If shares or other securities having voting power stand of record in the names of 2 or more persons, whether fiduciaries, members of a partnership, joint tenants, tenants in common, tenants by the entirety or otherwise, .. .their acts with respect to voting shall have the following effect:
>
> (1) If only 1 votes, his act binds all;
>
> (2) If more than 1 vote, the act of the majority so voting binds all;
>
> (3) If more than 1 vote, but the vote is evenly split on any particular matter, each faction may vote the securities in question proportionally, or any person voting the shares, . . .may apply to the Court of Chancery. . .to appoint an additional person to act with the persons so voting the shares, which shall then be voted as determined by a majority of such persons and the person appointed by the Court. . . .

Under the facts of this case, if there had been a shareholder vote on November 21, 1984, Reed would have been entitled to vote all 120 of the jointly held shares in favor of the Cook group if Tom had not cast an opposing vote or 60 of the jointly held shares if Tom did.

Inasmuch as a consent under § 228 is a substitute for a vote, the Cook group argues that § 217 must be applied to determine the number of "votes" represented in the consent. The Pumpellys counter that action by consent involves no voting. Indeed, § 228(a) specifically states that the consent procedure allows shareholder action "without a meeting, without prior notice and *without a vote*. . . ." Section 217(b) applies only to votes. The statute modifies the common law, under which both of the co-owners must act together to vote their stock. *See Sellers v. Joseph Bancroft & Sons Co.*, Del. Ch., 17 A.2d 831 (1941); *In Re Giant Portland Cement Co.*, Del. Ch., 21 A.2d 697 (1941);

5 *Fletcher Cyclopedia Corporations,* § 2038 (Perm. Ed.). Since § 217 is in derogation of the common law, the Pumpellys argue that it should not be expansively interpreted to apply to consents as well as votes.

[1] The rule that statutes in derogation of the common law will be strictly construed is not applied in all cases and should not be used to restrict the effectiveness of the statute. *See In Re Klingaman's Estate,* Del. Supr., 128 A.2d 311 (1957); *DeJoseph v. Faraone,* Del. Super., 254 A.2d 257 (1969). Section 217(b) was adopted, in part, to avoid disenfranchising shares. *See* Folk, *Report to Committee,* 143. If § 217 were interpreted to have no application to a consent procedure, co-owners of stock would be hampered in their ability to take shareholder action individually. Such a result would be inconsistent with the purpose of § 217.

[2] An interpretation which applies the voting rules of § 217 to a consent under § 228 would appear to give more complete effect to the purpose of both statutes. *See Nationwide Ins. Co. v. Graham,* Del. Supr., 451 A.2d 832 (1982). However, such an interpretation must recognize the fundamental differences between a vote, where all shareholders are given notice and the opportunity to express their views through the ballot, and a consent, where action is taken without prior notice to or involvement of the minority shareholders.

In the case of a vote, one co-owner of stock may vote all the shares if the other co-owner does not vote. In that situation, the silent co-owner may be deemed to have acquiesced in the vote that was cast. However, the same assumption cannot be applied in the case of a consent, where the "silent" co-owner is unaware that any shareholder action is being taken. Accordingly, the provision in § 217 that the vote of one co-owner binds all cannot be applied to a consent procedure.

However, if the consent of one co-owner is deemed to represent only one half of the shares in question, both statutes are given effect without doing violence to their respective purposes. A co-owner is able to make use of the consent procedure without effectively disenfranchising the other co-owner. By counting only the co-owner's proportional interest in the shares, the excluded co-owner is in the same position he would have been in if there had been a vote and he opposed the action taken. Accordingly, I conclude that Reed's consent on November 21, 1984 was effective as to 60 of the 120 jointly held shares.

[3] The question then becomes whether Strother's 30 shares (which had been transferred to Shaw Bay) were entitled to vote. Relying on the decision in *Norton v. Digital Applications, Inc.,* Del.

Ch., 305 A.2d 656 (1973), the Pumpellys argue that the Strother shares were not eligible to vote because they were not votable while in escrow and were not released from escrow for valid consideration or with the approval of the NTW board of directors. Alternatively, the Pumpellys contend that the release from escrow, if otherwise valid, violates the bankruptcy code.

In *Norton,* plaintiff agreed to sell all of the assets of his company in exchange for 600,000 shares of the defendant company's common stock. Pursuant to the agreement, half of those shares were transferred to plaintiff outright and the remaining shares were transferred into escrow for distribution to plaintiff over an 18 month period based upon profits earned from the assets purchased by the defendant company. Although the stock in that case was registered in Norton's name and listed as having been issued in certain filings with the SEC, this Court held that Norton was not entitled to vote the shares until they were released from escrow. The Court stated that delivery is necessary to complete the transfer of the shares and found, based upon the language of the agreement, that delivery into escrow was not a delivery to Norton for voting purposes. Stated another way, the shares were not "issued" until custody and control of the stock certificate passed to Norton.

Applying *Norton* to the facts of this case, I find that Strother's 30 shares were not eligible to vote while in escrow. Notwithstanding Strother's testimony to the contrary, I find that the stock certificate was not delivered to Strother at the time he executed his employment contract on February 29, 1984. Rather, I accept Malley's testimony that he retained custody and control of the stock certificate from the time it was prepared until it was released to Strother on August 10, 1984.

Although the language in the Strother employment contract is not as clear on this point as was the *Norton* agreement, I also find that legal ownership of the shares was not intended to pass to Strother until the conditions necessary to release the shares from escrow had been satisfied. While it is true that Strother paid $30 for the shares, as required by the employment contract, that payment did not constitute the full consideration for the stock. It is unreasonable to assume that Tom or the NTW board as a whole would have approved the sale of 30 shares of NTW stock at $1.00 per share when they were apparently worth more than $3000 per share. Moreover, under the terms of the employment contract, Strother would never have received the escrowed shares if he failed to perform under the contract or NTW's first stage growth objective was not achieved by July 1,

1985. Under these circumstances, I conclude that Strother could not acquire voting rights or legal ownership of the 30 shares until NTW received full consideration for the issuance of those shares.

The Cook group contends that the votability of the Strother shares while in escrow is irrelevant inasmuch as no one attempted to vote those shares while they were in escrow. However, the foregoing analysis goes a long way toward resolving the question of whether the Strother shares were validly released from escrow on August 10, 1984.

Pursuant to 8 *Del. C.* § 153, the NTW board of directors was required to and did determine the consideration for which Strother's shares were to be issued. However, the board did not act upon the substituted consideration pursuant to which the Strother shares were released in August. The Cook group argues that the NTW board authorized the issuance of the 30 shares when it approved the Strother employment contract on March 2, 1984 and that all Tom was doing in August, 1984 was releasing those shares. They say that Tom had the implied authority to do this since the NTW board was the instrument of Tom's will and existed in name only.

[4] This argument has some appeal if, as the Cook group does, one views the release from escrow as merely a modification to an employment contract. Having found that the release from escrow was a modification of the consideration for the issuance of shares, however, a different result obtains. By statute, that function lies with the board of directors and it has been held to be such a "vitally important duty" that it cannot be delegated. *Field v. Carlisle Corp.*, Del. Ch., 68 A.2d 817, 820 (1949). The absence of board approval requires the conclusion that Strother's shares were not validly released from escrow and, thus, not includable in the November 21, 1984 consent.

Thus, the first issue is resolved without reaching the Pumpellys' technical arguments concerning the order in which the stock certificates were executed at the closing on November 21, 1984 and the purported requirement that shareholders exercising a consent must remain shareholders of record throughout the day on which the action is taken. Similarly, it is unnecessary to decide the Pumpellys' fraud arguments or the serious question as to whether such defenses are within the scope of a § 225 proceeding. *See Kirkland v. International Community Corporation,* Del. Ch., C.A. No. 7577, Berger, V.C. (July 13, 1984). On November 21, 1984, the Cook group failed to effect a change in the board of directors of NTW because their consent did not represent more than 50% of NTW's outstanding stock.

It remains for the Court to determine whether new directors were elected at the shareholders meeting held on January 18, 1985. As noted earlier, Tom Pumpelly purported to vote 571 shares in favor of the three resolutions voted upon and the Cook group purported to vote 549 shares against the resolutions. Both sides voted the 120 jointly held shares; Tom Pumpelly voted an additional 39 shares issued to him on November 27, 1984; and the Cook group voted the 30 Strother shares.

The parties made numerous arguments as to the validity of the 39 shares issued to Tom in November and the authority of the trustees to vote the 120 jointly held shares. However, the result is controlled by the decision that Strother's shares are ineligible to vote. Starting with this premise, even under the "best case" the Cook group cannot prevail. Pursuant to § 217, the Cook group's vote of the jointly held shares could only count as 60 votes which, when combined with the 399 shares held by the trustees (429 less the 30 Strother shares) yield a total of 459 votes. If Tom Pumpelly's 39 newly issued shares and 60 of the 120 votes for the jointly held shares are excluded, the Pumpellys wind up with 472 votes. Accordingly, the shareholder vote on January 18, 1984 resulted in the election of Tom Pumpelly, Bell, Kenneth Rice and Maurice Whelan as the directors of NTW. IT IS SO ORDERED.

IN RE CROCKER SHAREHOLDERS LITIGATION

No. 7405

Court of Chancery of the State of Delaware, New Castle

May 21, 1985

As a result of an announcement by Crocker National Bank that it was making a special charge to 1983 fourth-quarter earnings, five stockholders derivative suits were filed soon after which six class action suits were also commenced. Subsequently, Midland Bank announced a proposal which would allow it to increase its ownership to 100% by a merger of Crocker with a wholly-owned subsidiary