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 number and classifications for this issue.

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BARBIERI v. SWING-N-SLIDE CORP.

No. 14,239

Court of Chancery of the State of Delaware, New Castle

May 7, 1996

Plaintiff filed a motion for class certification arising from an individual and class action claim against defendant corporation alleging: (1) breach of fiduciary duties to plaintiff and the class, (2) breach of duty of full disclosure in the offer, (3) election review pursuant to sections 225 and 227, (4) breach of the duty of disclosure in the proxy statement of April 4, 1995, and (5) breach of fiduciary duty and equitable fraud. The defendants filed a memorandum in opposition to plaintiff's motion for class certification arguing that the plaintiff had not adequately established the four elements of Chancery Court Rule 23(a) in order to bring a class action.

The court of chancery, per Chancellor Allen, concluded that the elements of Rule 23(a) had been met, certifying the class action. Recognizing the right of stockholders to bring individual and class actions in response to unfair self-tender offers, the chancellor concluded that the plaintiff demonstrated that he suffered a "special harm" and that he could adequately represent the class of named stockholders in this action.

1. Federal Civil Procedure ☞ 163, 165

The four prerequisites for a class action listed in Chancery Court Rule 23(a), identical in all respects to Rule 23(a) of the Federal Rules of Civil Procedure, are mandatory requirements. Plaintiff bears the burden of demonstrating that the four elements of Chancery Court Rule 23(a) have been satisfied in order to bring a class action suit. DEL. CH. CT. R. 23(a).

2. Corporations ☞ 202

The test used to distinguish between derivative and individual harm is whether the plaintiff has suffered "special injury." Special injury is established where there is a wrong suffered by the plaintiff that was not suffered by all stockholders generally.

3. Corporations ⚷ 186

The chancery court recognizes a plaintiff stockholder's right to bring individual and class actions in response to unfair self-tender offers.

4. Federal Civil Procedure ⚷ 164

Whether a plaintiff adequately represents a class depends on two factors: the plaintiff's attorney must be qualified, experienced, and generally able to conduct proposed litigation; and the plaintiff must not have interests antagonistic to those of the class. FED. R. CIV. P. 23(a)(4).

5. Federal Civil Procedure ⚷ 164

Because a class representative serves as a guardian of the interests of the class and thus has a fiduciary relationship to the class, the class representative owes to those whose cause he advocates a duty of finest loyalty. DEL. CH. CT. R. 23(a)(4).

6. Federal Civil Procedure ⚷ 176

The court may modify the class at any time prior to a decision on the merits of the case. This safeguard protects all concerned parties from unfair prejudice in the event further factual developments suggest the court should expand the class.

Michael Hanrahan, Esquire, and Elizabeth M. McGeever, Esquire, of Prickett, Jones, Elliott, Kristol & Schnee, Dover, Delaware; Terry Rose Saunders, Esquire, of Chicago, Illinois, of counsel; Joseph F. Devereux, Jr., of Devereux, Murphy, Striler & Brickey, L.L.C., of St. Louis, Missouri, of counsel; and Kevin J. Richter, Esquire, of Mathis Marifian Richter & Grandy, Ltd., of Belleville, Illinois, of counsel, for plaintiff.

Donald E. Reid, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware; and Theodore J. Low, Esquire, Jane B. McCullough, Esquire, and Andrew R. Greene, Esquire, of Altheimer & Gray, Chicago, Illinois, of counsel, for defendants.

Gregory P. Williams, Esquire, and Robert J. Stearn, Jr., Esquire, of Richards, Layton & Finger, Wilmington, Delaware; John S. Skilton, of Foley & Lardner, Madison, Wisconsin, of counsel; Douglas M. Hagerman, Esquire, and Michael J. Aprahamian, Esquire, of Foley &

Lardner, Milwaukee, Wisconsin, of counsel, for defendants GreenGrass Holdings and GreenGrass Management, LLC.

STEELE, *Vice-Chancellor*

CONTENTIONS OF PARTIES

On June 14, 1995, Plaintiff, Robert Barbieri ("Barbieri"), filed a motion for class certification arising from an individual and class action claim against Defendants, Swing-N-Slide Corporation ("Swing-N-Slide") and its eight directors.[1] The Complaint, which Plaintiff filed on April 17, 1995, stems from a self-tender offer ("the Offer") Swing-N-Slide made for 3,600,000 shares of Swing-N-Slide common stock at $11.00 per share.

The Complaint (with its amendment) consists of five counts: (I) Breach of Fiduciary Duties to Plaintiff and the Class, (II) Breach of Duty of Full Disclosure in the Offer, (III) Election Review Pursuant to 8 Del. C. §§ 225 and 227, (IV) Breach of Duty of Disclosure: April 4, 1995 Proxy Statement, and (V) Breach of Fiduciary Duty and Equitable Fraud.

Plaintiff brought Counts I and II on his behalf and on behalf of all other common stockholders of Swing-N-Slide on November 14, 1994, the last full trading day before Swing-N-Slide commenced the Offer. Plaintiff brought Counts III and IV on his behalf and on behalf of all other common stockholders on March 15, 1995, the record date for stockholders entitled to vote at Swing-N-Slide's April 25, 1995 annual stockholders meeting. Plaintiff brings Count V as an individual and class action on behalf of stockholders of Swing-N-Slide against Swing-N-Slide, its directors, and Greengrass Holdings.

On November 3, 1995, Defendants filed their *Memorandum in Opposition to Plaintiff's Motion for Class Certification.* On February 13, 1996, this Court held oral argument. This is the Order ruling on Plaintiff's motion.

---

[1]In his February 6, 1996, *Amendment and Supplement to the Complaint Count V - Breach of Fiduciary Duty and Equitable Fraud,* Plaintiff adds Greengrass Holdings ("Greengrass") and Greengrass Management, LLC ("Greengrass Management") to his list of Defendants.

FACTUAL BACKGROUND

Swing-N-Slide is a Delaware corporation with its principal executive offices in Janesville, Wisconsin. The company manufacturers and markets wooden home playground equipment.

Swing-N-Slide's director-Defendants are Thomas A. Baer ("Baer"), Richard G. Mueller ("Mueller"), Andrew W. Code ("Code"), James M. Dodson ("Dodson"), Peter M. Gotsch ("Gotsch"), Terence S. Malone ("Malone"), Henry B. Pearsall ("Pearsall"), and Brian P. Simmons ("Simmons"). As of November 14, 1994, Defendants owned over 50 percent of the outstanding shares of Swing-N-Slide common stock.

Code and Simmons also controlled an investment banking firm — Code, Hennessey & Simmons Limited Partnership ("CHS"). CHS formed Swing-N-Slide on January 10, 1992 to acquire the assets and business of its predecessor company. CHS bought 4,166,305 shares at $0.29 per share. Baer owned 75 percent of the predecessor company. As part of CHS's acquisition deal, Baer received 1,015,875 shares at $0.29 per share. He also entered into a highly profitable non-competition agreement — Baer would receive more than $6 million in payments from Swing-N-Slide beginning in 1997.

On August 28, 1992, Swing-N-Slide stock began trading on NASDAQ. Between 1992 and 1993, the stock traded at prices ranging from 9 and 3/8 to 17 and 3/4.

On July 28, 1994, Swing-N-Slide announced it hired Solomon Brothers to evaluate strategic alternatives and to consult on how to increase shareholder value. Swing-N-Slide focused on six options: (1) sale of the company, (2) a merger, (3) Swing-N-Slide's acquisition of the common stock, (4) a special dividend, (5) a share purchase, (6) or a recapitalization.

On November 15, 1994, Swing-N-Slide announced the Offer to purchase up to 3,600,000 of the 9,600,000 shares of Swing-N-Slide common stock. The company set the purchase price at $11.00 per share. The Offer stated CHS intended to tender all its shares. Swing-N-Slide also indicated the Offer was contingent on CHS or its partners tendering and not withdrawing 1.5 million of their Swing-N-Slide shares. At the time of the Offer, CHS owned 43.4 percent of Swing-N-Slide's common stock.

Plaintiff alleges during the Offer, CHS secretly distributed all of its shares of Swing-N-Slide common stock to its partners but did not disclose the distribution until after the self-tender closed on January 5, 1995. Defendants financed the purchase of the stock with $45 million of new bank borrowings.

Plaintiff alleges the Offer did not disclose CHS's distribution of its shares to its partners nor did it disclose the company had incurred $45 million in new bank borrowings to finance the self-tender. Plaintiff insists Defendants made the Offer with completely selfish motivation — to create a market for Defendants' to dispose of their Swing-N-Slide shares. Despite Plaintiff's allegations, the Offer stated "The Offer will afford to stockholders. . . the opportunity to dispose of Shares without the usual transaction costs associated with a market share." The price of Swing-N-Slide stock dropped consistently after the Offer terminated.

On January 18, 1995, Defendants announced Swing-N-Slide stockholders had tendered 9,268,335 shares. CHS's General Partner, CHS Management, made more than $3.3 million in the tender. Defendants Code and Hennessey held a 60 percent interest in CHS Management.

In February, 1995, Swing-N-Slide announced it had taken an after-tax charge of $2,050,000 during the fiscal quarter in which it had made the Offer. It revealed the charge enabled it to write off the non-compete agreements of Baer, Dodson and others which the company had already paid.

In April, 1995, Swing-N-Slide issued a Proxy Statement for its annual stockholders meeting. All the individual Defendants sought re-election. The Proxy Statement did not disclose the information concerning the Offer and its alternatives, the distribution to CHS partners, or the write-off.

Before filing the Complaint, Plaintiff initiated two telephone calls to Swing-N-Slide's outside counsel to complain the price of his shares decreased sharply as a result of the Offer. Defendants contend Plaintiff demanded the company buy back his remaining shares at his average cost. Additionally, Defendants claim Plaintiff threatened to sue Swing-N-Slide unless it pay him some $25,000. While the actual content of these conversations is murky, it is clear Plaintiff approached Swing-N-Slide to settle his demand for compensation.

CONCLUSIONS OF LAW

[1] Chancery Court Rule 23(a) requires a plaintiff establish four elements in order to bring a class action:

> (1) The class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of

> the class, and (4) the representatives parties will fairly and adequately protect the interests of the class.

Once brought, this Court must determine whether to maintain the class action. Chancery Court Rule 23(b). To maintain the class action this Court must also find:

> (1) The prosecution of separate actions by or against individual members of the class would create a risk of:
>
> > (A) Inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or
> >
> > (B) Adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests; or
>
> (2) The party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or
>
> (3) The Court finds that the question of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matter pertinent to the findings include:
>
> > (A) The interests of members of the class in individually controlling the prosecution or defense of separate actions;
> >
> > (B) The extent and nature of any litigation concerning the controversy already commenced by or against members of the class;
> >
> > (C) The desirability or undesirability of concentrating the litigation of the claims in the particular forum;
> >
> > (D) The difficulties likely to be encountered in the management of a class actions.

A plaintiff has the burden of establishing it has satisfied the requirements of Rule 23. ***Rosen v. Juniper Petroleum Corp.***, Del. Ch., C.A. No. 7016, Berger, V.C. (Apr. 11, 1986), Mem. op. at 2.

Defendants argue, "[Plaintiff] does not and cannot claim that he or any particular class of shareholders was specially injured by the alleged resulting decline in the price of the Company's shares." *Defendants' Memorandum in Opposition to Plaintiff's Motion for Class Certification* at 3. Defendants insist any alleged injury resulting from the Offer affected all stockholders equally. They recharacterize Plaintiff's claim: "[Swing-N-Slide] . . . was weakened because [Swing-N-Slide] paid too much to [Plaintiff] and the class he seeks to represent." *Id.* at 1. They argue the injury, if any, is to the corporation itself and indirectly to the individual stockholders. Thus, any claim should be derivative, not individual or class action. I disagree.

[2] Delaware courts distinguish between derivative harm and individual harm by scrutinizing whether a plaintiff has suffered "special harm." ***In re Tri-Star Pictures, Inc. Litig.***, Del. Supr., 634 A.2d 319, 330 (1993) (*citing* ***Lipton v. News Int'l, Plc.***, Del. Supr., 514 A.2d 1075, 1078 (1986); ***Moran v. Household Int'l, Inc.***, Del. Ch., 490 A.2d 1059, 1070, *aff'd*, Del. Supr., 500 A.2d 1346 (1985).

> A special injury is established where there is a wrong suffered by plaintiff that was not suffered by all stockholders generally or where the wrong involves a contractual right of the stockholders, such as the right to vote. ***Lipton***, 514 A.2d at 1078; ***Rabkin v. Phillip A. Hunt Chem. Corp.***, Del. Ch., 547 A.2d 963, 968-69 (1986); ***Moran***, 490 A.2d at 1070.

Tri-Star, 634 A.2d at 330.

For a plaintiff-stockholder to bring an individual action, it must allege an injury distinct from other stockholders. ***Kramer v. Western Pac. Indus.***, Del. Supr., 546 A.2d 348, 351 (1988). That court wrote:

> The distinction between derivative and individual actions rests upon the party being *directly* injured by the alleged wrongdoing. . . . Thus, to have standing to sue individually, rather than derivatively on behalf of the corporation, the plaintiff must allege more than an injury resulting from a wrong to the corporation. . . . For a plaintiff to have standing to bring an individual action, he must be injured *directly* or *independently* of the corporation. *See* ***Bocat v.***

> *Getty Oil Co.*, Del. Supr., 262 A.2d 246, 249 (1970). (emphasis in original).

Id. Chancellor Allen has stated:

> An alleged wrong involving a corporation is individual in nature when it injures the shareholders directly or independently of the corporation. ***Kramer v. Western Pac. Indus.***, Del. Ch., 546 A.2d 348, 351; ***Moran v. Household Int'l., Inc.***, Del. Ch., 490 A.2d 1059, 1070 (1985), ***aff'd***, Del. Supr., 500 A.2d 1346 (1985). A wrong is derivative in nature when it injures the shareholders indirectly and dependently through direct injury to the corporation. ***Kramer***, 348 A.2d at 353.

Avacus Partners, L.P. v. Brian, Del. Ch., C.A. No. 11001, Allen, C. (Oct. 24, 1990) Mem. op. at 12.

[3] At the threshold level, Plaintiff has demonstrated special injury to the class. The pleadings indicate Swing-N-Slide's directors and controlling stockholders had information regarding the Offer the minority public stockholders did not. The allegation of such unfair dealing unequally affected Swing-N-Slide stockholders causing a distinct injury to the minority. One group of stockholders benefitted from the selective dissemination of information while the same information was not made available to other shareholders. The directors' privileged access to the non-public information insulated them from the same injury the public stockholders suffered. Thus, Plaintiff's contention of individual injury is persuasive. The pleadings indicate they did suffer "special injury" distinct from other stockholders. *See* ***In re Tri-Star Pictures***, 634 A.2d at 332. This Court recognizes the right of stockholders to bring individual and class actions in response to unfair self-tender offers. *See, e.g.*, ***Eisenberg v. Chicago Milwaukee Corp.***, Del. Ch., 537 A.2d 1051 (1987); ***AC Acquisitions Corp. v. Anderson, Clayton & Co.***, Del. Ch., 519 A.2d 103 (1986); ***Kahn v. United States Sugar Corp.***, Del. Ch., C.A. No. 7313, Hartnett, V.C. (Dec. 10, 1985). The alleged failure to disclose material information to Swing-N-Slide's public stockholders also substantiates Plaintiff's right to bring an individual and class claim. ***Tri-Star Pictures***, 634 A.2d at 331-32; ***Lynch v. Vickers Energy Corp.***, Del. Supr., 383 A.2d 278, 279 (1978). Plaintiff properly classified his claim as a class action, not a derivative action.

Defendants present an alternative argument to their flawed contention Plaintiff's claim should be derivative. They argue, in the

event this Court finds Plaintiff's claim to be an individual action, Plaintiff cannot meet the requirements of Rule 23(a)(4). However, Defendants do not contest Plaintiff has met his burden of proof with regard to the first three requirements of Rule 23 — (1) numerosity of class members, (2) common questions of law and fact, and (3) typicality of the claims of the class. After reviewing Plaintiff's pleadings, I agree Plaintiff unequivocally satisfies the first three requirements of Rule 23.

Defendants do challenge Plaintiff as an appropriate representative of the class. They argue Plaintiff cannot meets his burden as to Rule 23(a)(4) regarding the absence of conflict and an assurance of vigorous prosecution, and therefore, this Court should deny the certification. I disagree.

[4] "Adequate representation [of a class] depends on two factors: (a) the plaintiff's attorney must be qualified, experienced, and generally able to conduct the proposed litigation, and (b) the plaintiff must not have interests antagonistic to those of the class." *Wetzel v. Liberty Mutual Ins. Co., 508 F.2d 239, 247 (3d. Cir.), cert. denied,* 421 U.S. 1011 (1975). Here, Defendants claim Plaintiff is unfit to represent the class because (1) he will not adequately protect the class, and (2) he "unfairly attempts to exclude a significant portion of [Swing-N-Slide]'s shareholders from the class. . . .[,]" namely, the non-Defendant Limited Partners of CHS. *Defendants' Memorandum in Opposition to Plaintiff's Motion for Class Certification* at 5, 10.

Defendants base their conclusion primarily on allegedly inculpating discussions between Plaintiff and Defendants' counsel. Defendants claim Plaintiff complained the price of his shares declined significantly as a result of the Offer. They also allege Plaintiff urged Defendants' counsel to make a payment to Plaintiff to avoid legal action against Swing-N-Slide.[2] In Defendants' counsel's affidavit, he attests to the above and states Plaintiff explained to him he was unconcerned with the well-being of the other common stockholders. Defendants include a letter from counsel to Plaintiff confirming the content of these discussions. Defendants argue these communications indicate Plaintiff is an unacceptable representative of the class.

[5] Even if the only reasonable inferences from these discussions were as Defendants depict, they do not indicate Plaintiff is an improper representative of the class.[3] First, Plaintiff's desire to settle to avoid litigation is logical and expected. This Court encourages settlement if

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[2]Defendants insist Plaintiff asked their counsel to guise this payment as a "consulting fee" to avoid disclosure to other shareholders.

[3]Plaintiff is the only stockholder who has sued Swing-N-Slide challenging the Offer.

conducted in good faith. The record indicates Plaintiff had a good faith belief Swing-N-Slide's offer was improper and challenged it. Defendants are correct "[a] class representative owes to those whose cause he advocates a 'duty of the finest loyalty'." (*citing Folding Cartons, Inc. v. American Can Co.*, 79 F.R.D. 698, 703 (N.D. Ill. 1978)). However, I disagree with Defendants' propensity argument. Plaintiff's original self-serving demands on Swing-N-Slide's counsel to settle do not indicate he will act only on his own behalf during the litigation of the class action. If anything, he will vigorously pursue the action on behalf of his fellow class members because of the very interest motivating his first approach. Plaintiff's desire to succeed as the class representative, on his own behalf and on behalf of the other members, qualifies him as a proper class representative. I reject Defendants' contention Plaintiff is an unqualified class representative.

Defendants also argue Plaintiff is an unfit representative of the class because he "excluded from his definitions of the classes numerous shareholders who are accused of no wrong doing and who suffered precisely the same type of injury that plaintiff alleges he suffered." *Defendants' Memorandum in Opposition to Plaintiff's Motion for Class Certification* at 10. Again I disagree.

The Complaint alleges the Limited Partners received information regarding the Offer which the other stockholders did not receive. Plaintiff also represents discovery documents reflect the limited dissemination of information to Limited Partners but not to the general population of common stockholders. Exhibits D and E to *Plaintiff's Reply Memorandum to Defendants' Memorandum in Opposition to Plaintiff's Motion for Class Certification* support his contention.

[6] Finally, in regard to Plaintiff's exclusion of Limited Partners from the class, this Court may modify the class at any time prior to a decision on the merits of the case. This safeguard protects all concerned parties from unfair prejudice in the event further factual developments suggest this Court should expand the class.

Defendants' final objection to certification rests on Plaintiff's inability to meet the requirements of Rule 23(b)(1) or (2).[4] Defendants submit the absence of individual issues in this case qualify it as a derivative suit, not a class action. This, they argue, precludes certification under Rule 23(b)(1). As I discussed *supra*, Plaintiff's claim is not derivative.

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[4]The advantage of certification under Rule 23(b)(1) or (b)(2) is that decision is *res judicata* as to the entire class. *Joseph v. Shell Oil Co.*, Del. Ch., C.A. No. 7450, Hartnett, V.C. (Feb. 8, 1995), Mem. op. at 9.

Defendants concede "it would be technically appropriate to certify a class under Rule 23(b)(2) for plaintiff's claims in Counts III and IV because these counts seek only injunctive-type relief relating to the annual meeting of shareholders." *Defendants' Memorandum in Opposition to Plaintiff's Motion for Class Certification* at 15. They claim, however, these counts are "makeweight." I cannot agree.

At this stage, this Court does not address the merits of Plaintiff's case. This opinion focuses on the appropriateness of class certification, nothing more. At this time, these counts do not appear frivolous. I also find they are better suited for class certification under Rule 23 regardless if Plaintiff ultimately succeeds. These counts may stand, and this Court certifies Counts III and IV under Rule 23(b)(2).

As for Counts I and II, Defendants contend it is inappropriate to certify them under Rule 23(b)(2). They claim Counts I and II seek predominately monetary relief which is improper under Rule 23(b)(2). While Defendants are correct — Plaintiff does seek monetary damages under Counts I and II, Plaintiff asks for the requisite "injunctive relief or correspondingly declaratory relief with respect to the class as a whole." In addition to monetary relief, Plaintiff seeks: (1) a declaration Defendants have violated their fiduciary duties, (2) an imposition of a constructive trust on all proceeds Defendants received as a result of the offer[5], (3) a declaration Defendants Baer and Dodson remain subject to the non-competition agreements, (4) a declaration the election of directors and other matters the directors voted on at the April 25, 1995 annual meeting are invalid, (5) an order mandating the holding of an annual meeting upon full disclosure and with stockholders permitted to submit proposals for inclusion in Swing-N-Slide's Proxy Statement and form of proxy, (6) a grant of any additional fair and equitable relief this Court deems. Certification is appropriate under Rule 23(b)(2).[6]

This Court has never received any opposition to Plaintiff's request to certify Count V as he indicated in his *Amendment and Supplement to the Complaint Count V — Breach of Fiduciary Duty and Equitable Fraud.*[7] Count V seeks predominantly injunctive relief including an order temporarily, preliminarily, and permanently enjoining the Offer, the

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[5]Obviously, this equitable relief, if successful, would also include a monetary component.

[6]Regardless of Rule 23(b)(2)'s applicability, both parties agree certification is appropriate under Rule 23(b)(3).

[7]Defendants did submit their *Opening Brief in Support of Defendants Greengrass Holdings and Greengrass Management, LLC's Motion to Dismiss* to challenge Count V. It does not address certification of Count V. The motion does not preclude me from certifying this count. I will rule on the Motion to Dismiss in a separate opinion.

Securities Purchase between Swing-N-Slide and Greengrass, and Swing-N-Slide's subsequent public offering pursuant to the Transaction Agreement between Greengrass and Swing-N-Slide, and an order rescinding the transaction between Swing-N-Slide and Greengrass. Accordingly, I certify Count V as a class action under Rule 23(b)(2).

I certify the class as to Counts I-V of Plaintiff's claim. A separate order will follow.

ORDER

For the reasons set forth in the Court's Memorandum Opinion dated May 7, 1996:

This Court certifies the class for Counts I-V of Plaintiff's claim.

IT IS SO ORDERED.

CARLTON INVESTMENTS v. TLC BEATRICE INTERNATIONAL HOLDINGS, INC.

No. 13,950

Court of Chancery of the State of Delaware, New Castle

April 16, 1996

Carlton Investments, the plaintiff in this action, sought leave to amend its complaint for a second time. Carlton sought to amend the factual allegations in the original complaint, to assert new claims, and to add defendants. Carlton had originally filed this shareholders' derivative action to recover assets allegedly diverted from TLC Beatrice to the late Reginald F. Lewis, who is alleged to have been a controlling shareholder of Beatrice.

Defendants argued that Carlton's motion to amend should be cleared based upon their claims that: (1) Carlton lacked standing, (2) the claims are time-barred, (3) the fraud claims were not pled with particularity, and (4) Carlton failed to state a claim upon which relief could be granted.

The court of chancery, per Chancellor Allen, held that Carlton's claims are legally sufficient. Therefore, the court granted Carlton leave to file a second amended complaint.

1. Pleading ⟹ 229, 233

Leave to amend a pleading shall be freely given when justice so requires. Therefore, leave to amend a pleading is generally granted unless there is a showing of substantial prejudice or legal insufficiency. DEL. CH. CT. R. 15(a).

2. Pleading ⟹ 193(5)
Pretrial Procedure ⟹ 622

Legal insufficiency should be found when the interests of justice so require or it appears reasonably certain that under any set of proven facts, the plaintiff would not be entitled to relief.

3. Pretrial Procedure ⟹ 675

With a motion to amend, all factual allegations must be accepted as true and all inferences must be construed in favor of the plaintiff.

4. Corporations ⟹ 310(1), 320(1)

The plaintiff has no obligation to plead or prove injury as part of a breach of fiduciary duty claim.

5. Pleading ⟹ 34(1)
Corporations ⟹ 310(1), 312(3)

An allegation that the controlling shareholder of the corporation manipulated the employee stock option compensation plan in order to confer advantages on himself without full disclosure to the board states a claim on which relief may be granted.

6. Limitation of Actions ⟹ 180(7)

The plaintiff has the burden of pleading facts that support a conclusion that the tolling principle would apply when the complaint shows the claim to be otherwise stale.

7. Limitation of Actions ⟹ 100(7)

The pleading burden may be met by allegations of some affirmative act of concealment or by alleging that (1) the defendant had a fiduciary relation with plaintiff, (2) there was self-dealing by the defendant, and (3) plaintiff did not know or have reason to know of the facts giving rise to the alleged wrong.

8. Pleading ⟹ 216(2)

In the context of a motion to dismiss, under certain circumstances, the court may consider documents incorporated in a complaint.

9. Limitation of Actions ⟹ 37
Corporations ⟹ 312(3)

An allegation that the controlling stockholder actively concealed his self-interest in payments from the corporation to the law firm which he controlled clearly establishes the applicability of the tolling principle.

10. Pleading ⟹ 8(15)

All averments of fraud shall be stated with particularity. DEL. CH. CT. R. 9(b).

11. Pleading ⟹ 16

Allegations are pled with sufficient particularity if they place the defendants on notice of the precise misconduct with which the defendant is charged.

12. Pleading ⟹ 8(15)

Allegations which are consistent with a conclusion that excess fees were funnelled to the controlling shareholder through an undisclosed arrangement states a claim for fraud with sufficient particularity.

13. Pleading ⟹ 8(15)

For purposes of a fraud claim, a representation reasonably implied from an alleged statement is all that is needed to sufficiently plead a false statement.

14. Pleading ⟹ 8(15)

Allegations that the controlling shareholder failed to correct the board's mistaken belief that he was no longer receiving compensation from his former law firm sufficiently pled a claim that the controlling stockholder committed fraud.

15. Corporations ⟹ 210

It is well settled that in a standard double derivative action both the parent and subsidiary corporations are indispensable parties.

16. Pretrial Procedure ⟹ 624, 683

To avoid dismissal at the pleading stage, the plaintiff only needs to allege enough factual information to permit an inference that the charges may be correct and put the defendants on notice of the claims.

17. Pleading ⟹ 8(1)

A party is only required to plead knowledge generally.

18. Pleading ⟹ 229, 233
Pretrial Procedure ⟹ 695

Where the plaintiff's allegations are legally sufficient, leave to amend the complaint should be granted unless there is a showing of substantial prejudice.

19. Pleading ⟹ 229

Rule 15 adopts a permissive approach toward amending pleadings during pretrial discovery. DEL. CH. CT. R. 15.

Rodman Ward, Jr., Esquire, Cathy L. Reese, Esquire, and Herbert W. Mondros, Esquire, of Skadden, Arps, Slate, Meagher & Flom, Wilmington, Delaware, for plaintiff Carlton Investments.

Michael D. Goldman, Esquire, and Stephen C. Norman, Esquire, of Potter Anderson & Corroon, Wilmington, Delaware; Gregory V. Varallo, Esquire, and Matthew E. Fisher, Esquire, of Richards, Layton & Finger, Wilmington, Delaware; Henry E. Gallagher, Jr., Esquire, of Connolly,

Bove, Lodge & Hutz, Wilmington, Delaware; David J. Margules, Esquire, of Wolf, Block, Schorr and Solis-Cohen, Wilmington, Delaware; David C. McBride, Esquire, and William D. Johnston, Esquire, of Young, Conaway, Stargatt & Taylor, Wilmington, Delaware; William M. McErlean, Esquire, Richard S. Huszagh, Esquire, and John F. Verhey, Esquire, of Rudnick & Wolfe, Chicago, Illinois, of counsel; and Thomas P. Puccio, Esquire, New York, New York, of counsel, for defendants.

ALLEN, *Chancellor*

Pending is a motion by plaintiff, Carlton Investments, for leave to file a second amended complaint.[1] Plaintiff seeks to amend the factual allegations in the original complaint to assert new claims and add additional defendants. The motion was presented on March 11, 1996.[2] Although Carlton's first amended complaint already contains a substantial number and variety of allegations, the interests of justice here persuade me that Carlton should nevertheless be permitted to make these amendments. Thus for the reasons that follow the motion is granted.

I. Background and Stage of Proceedings

Carlton Investments, which allegedly owns approximately 22 percent of the outstanding common stock of TLC Beatrice, filed this stockholders' derivative action on January 4, 1995, to recover assets allegedly diverted from TLC Beatrice to the late Reginald F. lewis, who is alleged to have been a controlling shareholder of TLC Beatrice. The defendants are the Estate of Reginald Lewis; various individuals who serve or served as directors of TLC Beatrice; TLC Transport, a wholly owned subsidiary of TLC Beatrice; several companies owned by Lewis and who allegedly participated in or benefitted from the misappropriation and waste; and TLC Beatrice, the beneficiary of the action.

The original complaint alleges, among other things, that Lewis breached his fiduciary duties to TLC Beatrice and its minority stockholders, and misappropriated and wasted corporate assets by causing the company to enter into certain transactions between 1988 and 1992. As alleged, these transactions include causing the company to:

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[1]Carlton amended its complaint once as a matter of course on August 15, 1995.

[2]The motion was presented along with several motions to compel discovery. The discovery disputes were resolved in a March 15 Memorandum Opinion and Order.

(1) pay him, weeks before his death from a known but undisclosed brain tumor, $22.1 million, which included the reimbursement of $2.6 million for legal fees incurred by Lewis in an action unrelated to TLC Beatrice;

(2) pay him millions of dollars in undocumented "living expenses";

(3) make improper payments to TLC Group, L.P., a limited partnership owned by Lewis and his daughters' trust, including the payment of salaries, bonuses, and severance for employees of TLC Group, L.P., the reimbursement of TLC Group, L.P. for various expenses, including payments of taxes and governmental levies for other Lewis-owned entities, payments to trusts for the benefit of Lewis' daughters, payments to affiliated law firms on matters unrelated to TLC Beatrice, and payments to McCall Pattern Holdings;

(4) pay rent for office facilities for lewis-owned entities;

(5) lease, purchase, and maintain a corporate jet largely for the personal use of Lewis; and

(6) redeem the company's preferred stock so that Lewis could cash out his shares.

This suit follows Carlton's filing of an individual action in the state of New York against TLC Beatrice and the Lewis Estate which sought recovery of approximately $11 million for alleged breaches of a stockholder agreement signed by Lewis, Carlton, and TLC Beatrice. In that suit, Carlton challenged the propriety of the $22.1 million compensation package, arguing that under the stockholders' agreement the payments to Lewis trigger a right to proportionate payments to Carlton.

Shortly after this Delaware litigation was initiated, TLC Beatrice filed a motion for dismiss or stay this case and to stay discovery on several grounds, including the existence of the prior pending new York suit. Defendants' motion to stay discovery was granted only in part and Carlton continued limited discovery efforts.[3] In March 1995, the parties

[3]Discovery against the estate of Reginald Lewis, TLC Group L.P., and certain director defendants was stayed pending the outcome of the motion to dismiss.

entered into a stipulated stay of proceedings pending settlement discussions. The settlement discussions were unsuccessful and the stay of proceedings expired July 19, 1995, when Carlton filed its opposition to defendants' motion to dismiss. Carlton's discovery, to the extent it was not previously stayed pending the outcome of the motion to dismiss, then continued. On November 21, 1995, the court issued an opinion denying defendants' motion to dismiss or stay and shortly thereafter both parties began full discovery efforts.

II. Carlton's Motion to Amend

On February 12, 1996, Carlton sought leave to amend its complaint to add four new claims.[4] In summary form, these claims entail allegations that:

> (1) In 1988, Lewis, without disclosure to the board of relevant information, and in contravention of the Stockholders' Agreements between Lewis, Carlton and TLC Beatrice, required certain TLC Beatrice employees to enter into Stock Purchase Agreements that granted Lewis an irrevocable proxy to vote the 750,000 shares of TLC Beatrice stock issued to these employees;
>
> (2) Lewis continued to exercise control over and received remuneration from the law firm Lewis & Clarkson and caused TLC Beatrice to pay millions of dollars in legal fees to this two-attorney firm after he had announced to the board in 1988 that he had "resigned" from the law firm;
>
> (3) Lewis also diverted assets from TLC Beatrice's foreign subsidiaries, particularly certain French subsidiaries that Lewis dominated and controlled; and
>
> (4) Lewis, and director defendants, Jean Fugett and Leslie Lewis knew but failed to disclose to the board that Lewis was suffering from an inoperable brain tumor at the time the board voted to approve Lewis' compensation package in 1992 and thereby breached their fiduciary duties to the corporation.

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[4]Carlton originally sought to add five new claims, but subsequently withdrew allegations with respect to one of those new claims.

Carlton also seeks to join as individual defendants (i) David Guarino, a former TLC Beatrice officer and director, who allegedly conspired with Lewis to obtain over $1 million in "expense reimbursements" for Lewis from TLC Beatrice without providing the necessary receipts, and who allegedly voted to ratify Lewis' compensation package; and (ii) W. Kevin Wright, a former officer and general counsel of TLC Beatrice and other Lewis entities and law partner at Lewis & Clarkson, who allegedly conspired with Lewis to divert assets from TLC Beatrice. In addition, Carlton seeks to join as nominal defendants certain TLC Beatrice French subsidiaries that Lewis allegedly used to divert assets to himself. Finally, Carlton sought to add counts of fraud and usurpation of corporate opportunity against the Lewis Estate and Lewis' alleged co-conspirators.

[1] Chancery Court Rule 15(a) states that leave to amend a pleading "shall be freely given when justice so requires." Leave is therefore granted unless there is a showing of substantial prejudice or legal insufficiency. *Kahn Bros & Co. v. Fischbach Corp.*, Del.Ch., C.A. No. 8987, Allen, C. (Sept. 19, 1989). Here, defendants oppose the motion arguing both that the new claims are legally insufficient (that they could not withstand a motion to dismiss) and that the proposed amendments would substantially prejudice them. I address first the legal sufficiency of Carlton's new allegations.

III. The Legal Sufficiency of Carlton's New Claims

[2-3] With respect to each of Carlton's new claims, Carlton's motion should be denied only if the interests of justice so require or if it appears reasonably certain that under any set of facts which could be proven to support that claim, Carlton would not be entitled to relief. *See, e.g., Rabkin v. Phillip A. Hunt Chemical Corp.*, Del.Ch., 480 A.2d 655, 662 (1984), *rev'd on other grounds*, Del.Supr., 498 A.2d 1099 (1985); *In Re Maxxam, Inc.*, Del.Ch., C.A. Nos. 12111 & 12353, Jacobs, V.C. (Apr. 13, 1993) (both stating that leave to amend would be denied where the new claim would be subject to dismissal). As with a motion to dismiss, all of the factual allegations must be accepted as true and all inferences must be construed in favor of the plaintiff in making this determination. *See, e.g., Weinberger v. UOP, Inc.*, Del.Ch., 409 A.2d 1262, 1263-64 (1979).

A. The allegations that in 1988 Lewis wrongfully acquired proxies from certain employees

Carlton alleges that Lewis caused the TLC Beatrice Board to issue 750,000 shares of common stock to certain TLC Beatrice executives that he selected and that those executives, in turn, were required to execute stock purchase agreements granting Lewis an irrevocable proxy over the newly issued shares. It is further alleged that lewis paid nothing for these voting rights, that he did not disclose to the board that he intended to obtain these irrevocable proxies, and that the board failed to exercise any oversight or make any inquiry about the terms of the stock purchase agreements.

1. Standing

Defendants first assert that Carlton lacks standing to challenge the transactions by which Mr. Lewis obtained proxies to vote shares issued to employees or officers. Their theory is that an aggrieved party must have suffered a direct injury to have standing to litigate a claim arising out of it and that there is no allegation that TLC Beatrice, on whose behalf this derivative claim was brought, has suffered any injury or damage as result of these agreements. Although Carlton contended that Lewis received the voting rights "at the expense of the Company," the defendants suggest that because the company never had the right to vote the shares, it could not have suffered a loss as a result of the transfer of the voting rights. According to the defendants, any loss was suffered by the individuals and not by the company because the right to vote the shares was held by the stockholders who, pursuant to the agreements, conveyed those rights to Lewis. The theory is unsound in my opinion.

It is difficult to identify a specific loss to the corporation only because it is difficult to specify the consideration that supports the granting of options to employees. But if one assumes that in fact TLC received some *quid pro quo*, it follows logically that it got less by way of fair exchange value than it would have gotten had the transfer included valuable voting rights. If, for example, TLC Beatrice was simply selling this stock to the public (with Lewis retaining the voting rights) it would be hard to contend that the company could not have gotten a higher price for shares <u>with</u> voting rights. Given that theory of stock option grants is premised on a belief in their beneficial employee incentive effect, in theory Lewis' alleged retention of irrevocable proxies deprived TLC

Beatrice from the additional incentive effect that granting more valuable stock presumptively entails.

[4] Furthermore, the allegations sufficiently state a claim for breach of fiduciary duty because Carlton has no obligation to plead and prove injury as part of such a claim. That is, "in a shareholder action against corporate directors an allegation of fact, which if proven at trial would be sufficient to strip the board of the business judgment presumption, states a claim upon which relief may be granted." *Orban v. Field*, Del.Ch., C.A. No. 12820, Allen, C. (Dec. 30, 1993), Mem. Op. at 14. *See also Cede & Co. v. Technicolor, Inc.*, Del.Supr., 634 A.2d 345, 371 (1993) (recognizing that there is no requirement that a shareholder plead and prove, as part of a prima facie case for breach of loyalty, that injury resulted).

[5] Here it is alleged that Lewis manipulated the employee stock option compensation plan in order to confer advantages on himself, without full disclosure to the board. Accepting this as true, it states a claim upon which relief may be granted. A claim of fiduciary duty does not require financial injury and it is simply not necessary at this stage to figure out what form of relief, if any, would be appropriate.[5]

2. Laches

The defendants next contend that this claim is barred by the doctrine of laches and the statute of limitations. According to the defendants, breach of fiduciary duty claims are subject to a three-year statute of limitations (pursuant to 10 *Del. C.* §8106) and Carlton's allegations themselves indicate that the stock purchase agreements were executed back in December of 1988.[6] Thus, defendants say, Carlton must plead facts that support a conclusion that the statute was tolled, which it has not done. Defendants point out that Carlton has not alleged that defendants committed any acts of concealment and argue that Carlton's contention that certain information was not discovered until litigation is insufficient to meet its pleading burden. Moreover, they say that the company's 1989 SEC Form 10-K disclosed the fact that these voting rights were transferred to Lewis.

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[5]With respect to relief, Carlton's complaint specifically asks that the voting rights granted to Lewis pursuant to these agreements be canceled.

[6]Technically, the equitable doctrine of laches rather than the statute of limitations is the appropriate concept here because Carlton asks this court for equitable rescission of the proxies. Of course, in considering the timeliness of Carlton's claim a court ordinarily gives great weight to an analogous statute of limitations. *See Adams v. Jankouskas*, Del.Supr., 452 A.2d 148, 157 (1982).

[6-7] To be sure, Carlton has the burden of pleading facts that support a conclusion that the tolling principle would apply, when, as here, the complaint shows the claim to be otherwise stale. *See Litman v. Prudential-Bache Properties, Inc.*, Del.Ch., C.A. No. 12137, Chandler, V.C. (Jan. 14, 1994), Mem. Op. at 8. That pleading burden may be met by allegations of some affirmative act of concealment or by alleging (1) that the defendant had a fiduciary relation with plaintiff, (2) that there was self-dealing by the defendant, and (3) that plaintiff did not know or have reason to know of the facts giving rise to the alleged wrong. *See Carlton Investments v. TLC Beatrice Int'l Holdings, Inc.*, Del.Ch., C.A. No. 13950, Allen, C. (Nov. 21, 1995) (citing *Kahn v. Seaboard Corp.*, Del.Ch., 625 A.2d 269 (1993)).

Here, plaintiff's allegations provide a sufficient basis to infer that Carlton did not know or have reason to know of the irrevocable proxies until the company produced documents in October of 1994 in response to Carlton's Section 220 action. Carlton's complaint alleges TLC Beatrice is "closely held" and "intensely private" and that prior to September of 1993 Carlton "had no representative on the Company's Board, or the boards of TLC Beatrice's subsidiaries and, thus, had to rely on the information Lewis chose to reveal to it." Carlton's complaint further alleges that it was the records TLC Beatrice produced pursuant to the settlement of the Section 220 action brought by Carlton that showed "a pervasive waste of TLC Beatrice's assets, largely for the benefit of Lewis." In my view, these allegations plead facts that, if true, sufficiently infer that the claim would qualify for the tolling principle.

[8] With respect to defendants' argument that TLC Beatrice's SEC filings definitively show that Carlton knew or should have known that Lewis received the irrevocable proxies, it would require this court to consider documents outside the pleadings in ruling on what is essentially a motion to dismiss. Although the court may, under certain circumstances, consider documents incorporated in a complaint,[7] defendants do not even suggest that Carlton's proposed amended complaint references these SEC filings. Thus, without considering the filings, I find that the allegations concerning Lewis's acquisition of irrevocable proxies are legally sufficient.

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[7] *See In Re Santa Fe Pac. Corp. Shareholder Litig.*, Del.Supr., No. 224, 1995, Veasey, C.J. (Nov. 22, 1995) Mem. Op. at 23 (discussing particular instances in which the court considered documents referred to in complaints).

B. Lewis's alleged fraud concerning payments to Lewis & Clarkson

Carlton's amended complaint alleges that in September 1988 Lewis misrepresented to the TLC Beatrice Board that he had resigned from Lewis & Clarkson, the law firm that he controlled. Carlton alleges that despite this announcement, Lewis continued to exercise control over and receive compensation from the firm and caused TLC Beatrice to pay millions of dollars in legal fees for several years following his resignation. Moreover, according to the allegations Lewis concealed from the board his ongoing self-dealing until the firm's dissolution; did not disclose then and the board never inquired concerning any such payments.

Defendants attack the legal sufficiency of these allegations on all fronts; suggesting that the claim is time barred, that Carlton has failed to plead fraud with particularity, and that Carlton has failed to state a claim upon which relief can be granted.

1. Laches and/or statute of limitations

Defendants argue that Carlton's pleadings show that the claim is time barred. To support their argument defendants point out 1) that Carlton's allegations show that Lewis & Clarkson dissolved in July 1992; 2) that Carlton does not allege that it was unaware of the payments to Lewis & Clarkson; 3) that the amount paid to Lewis & Clarkson each year was fully disclosed in the company's public filings; and 4) that Carlton has therefore failed to meet its burden of alleging facts sufficient to toll the statute of limitations.

[9] This argument skirts the central issue: whether Carlton's allegations, if true, show that it had no reason to know that Lewis was continuing to receive a portion of the profits of Lewis & Clarkson. It is the alleged fact of Lewis's continued participation in Lewis & Clarkson — his alleged undisclosed conflicting interest in payments to the firm — that forms the basis for a claim of self-dealing and fraud. As to that issue, Carlton specifically alleges that "Lewis defrauded the Company and breached his duty of loyalty by...actively concealing his lack of self-interest in payments from the Company to Lewis & Clarkson." Such an allegation, if true, clearly establishes the applicability of the tolling principle.

2. Failure to plead fraud with particularity

[10] Court of Chancery Rule 9(b) requires that "all averments of fraud... shall be stated with particularity." Although Carlton alleges that Lewis's representation that he had resigned from Lewis & Clarkson "constitute[d] misrepresentation[ ] of material fact made with the intention to deceive," the defendants contend that such a claim is based solely on conclusory allegations and does not satisfy the particularity requirements of Rule 9(b) because Carlton does not allege "when such payments were made or how much was paid." Moreover, defendants argue that Carlton has failed to allege actionable damages to the company as a result of these alleged payments. They say that Carlton has not challenged the amount paid by TLC Beatrice, but only the fact that Lewis & Clarkson made distributions to Lewis.

[11] Nonetheless, Carlton's allegations are pleaded with sufficient particularity "to place defendants on notice of the precise misconduct with which [Lewis is] charged." *See Kahn Bros. & Co. v. Fischbach Corp.*, Del.Ch., C.A. No. 8987, Allen, C. (Sept. 19, 1989), Mem. Op. at 11. The allegations state that (1) in order to deceive the directors that he was no longer receiving compensation from his law firm, Lewis misrepresented to the board on September 21, 1988, that he had resigned; (2) Lewis continued to receive payments from Lewis & Clarkson; and (3) Lewis actively concealed from the board his self-interest in the payments, particularly when the board approved a compensation package for him in the mistaken belief that he had not been previously compensated by the company. These alleged facts make clear the circumstances constituting the alleged fraud as required by Rule 9(b).

[12] The defendants' contention that Carlton has failed to allege adequately the damage element of common law fraud is likewise unavailing.[8] Admittedly, it is not *necessarily* the case that TLC Beatrice suffered harm if it relied upon Lewis's alleged misrepresentation; the services Lewis & Clarkson subsequently provided and the compensation it received may have been no different had the board known Lewis was still involved in the firm and may have been paid at the same rate. But the evidence may as easily be different. Carlton alleges that TLC Beatrice "continued to retain Lewis & Clarkson, to which it paid approximately $8 million in legal fees from 1987 through 1992, despite the fact that Lewis & Clarkson had only two or three lawyers at any

[8]Although defendants contend that Rule 9(b) requires that the plaintiff allege the damage element of fraud with particularity, I note that the Rule only requires that "the circumstances constituting fraud . . . be stated with particularity."

given time during this period." This allegation is more than conclusory and sufficiently puts defendants on notice of the precise way in which TLC Beatrice may have been harmed. The allegations are consistent with a conclusion that excess fees were funnelled to Mr. Lewis through the undisclosed arrangement as the pleadings leave this open as a possibility,[9] it states a claim for fraud with sufficient particularity. Discovery is available to both parties to explore relevant facts.

3. Failure to state a claim for relief

Reconceptualizing their argument again, defendants contend that Carlton has failed to state a claim for fraud because even assuming Lewis received payments from Lewis & Clarkson after his resignation, this alone would not constitute fraud. According to the defendants, Carlton *does not allege that Lewis ever stated that he would no longer receive compensation from Lewis & Clarkson* and therefore Carlton has inadequately alleged that Lewis made *a false statement*; the only falsity being the inference from lewis's statement that he had resigned from Lewis & Clarkson.[10]

[13-14] For purposes of a fraud claim, however, a representation reasonably implied from lewis's alleged statement is all that is needed to sufficiently plead a false statement. *See Glaser v. Norris*, Del.Ch., C.A. No. 9538, Chandler, V.C. (July 13, 1989), Mem. Op. at 10-11 (finding an alleged statement which implied certain representations to constitute sufficient pleading of a false statement). Carlton's allegations, if proven, could support a finding that the TLC Beatrice directors reasonably inferred from Lewis's statement that he had resigned from Lewis & Clarkson, that he would no longer have a financial interest in payments made to that firm by TLC Beatrice. Moreover, Carlton has alleged that Lewis actively concealed his ongoing self-interest with respect to payments made to Lewis & Clarkson. Thus, even if Lewis's initial alleged representation were not false, the allegations sufficiently plead a claim that he committed fraud when he failed to correct the board's

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[9]Carlton's complaint alleges that the TLC Beatrice board relied upon Lewis's misrepresentation "by continuing to retain Lewis & Clarkson as outside counsel, s well as by later approving a generous compensation package to Lewis on the belief that he had not been previously compensated by the Company."

[10]Defendants also say the Carlton has inadequately alleged that TLC Beatrice relied upon Lewis's representation and that damages resulted. As discussed previously, Carlton has sufficiently pled the damage element of common law fraud and that such potential injuries arose from the board's belief in Lewis's alleged misrepresentation.

mistaken belief that he was no longer receiving compensation from his former firm.

C. Carlton's claims relating to the French subsidiaries

In its second amended complaint, Carlton alleges that Lewis dominated and controlled TLC Beatrice's foreign subsidiaries, through an arrangement of tiers of holding companies, and he diverted corporate funds to his own benefit by taking control of the checkbooks and banking records of these subsidiaries (and making himself a signatory). According to the allegations, TLC Beatrice is simply a holding company and all of its operating subsidiaries, which are held through additional holding companies with no operations of their own, are foreign entities mostly located in France. Specifically, it is alleged that TLC Beatrice wholly owned Acquisition II, which in turn wholly owned TLC Beatrice France, which in turn wholly owned International Foods (Paris), which holds stock in certain French operating subsidiaries.

It is further alleged that Lewis used his control over these subsidiaries to engage in a variety of self-dealing transactions. First, Carlton alleges that Lewis caused one of these subsidiaries (International Foods) to sell a French company (Maxim Delrue), of which it owned 100%, to a related party for 20 million French francs; that the related party sold that same company to a third party two months later for 75 million francs; and that Lewis was the beneficiary of the difference. Second, Carlton alleges that Lewis, for his own benefit, caused a loan from one of the subsidiaries to Maxim Delrue (the previously wholly owned French company sold to a related party) to be forgiven for inadequate consideration. Finally, the second amended complaint alleges that Lewis's self-dealing resulted in the French tax authorities bringing a substantial claim that ultimately was charged to TLC Beatrice.

Defendants challenge the legal sufficiency of these proposed amendments concerning the French subsidiaries for lack of personal jurisdiction over the subsidiaries and failure to make a demand on the subsidiaries pursuant to Del. Ch. Rule 23.1. Carlton, in turn, argues that it has alleged sufficient facts that, if true, show that these subsidiaries are alter egos of TLC Beatrice and Lewis and that therefore jurisdiction over TLC Beatrice and Lewis constitutes jurisdiction over the subsidiaries. Carlton also argues that under its alter ego theory it only needs to allege that demand on TLC Beatrice would be futile and that even if demand upon the subsidiaries was required it was excused in this case.

1. Personal jurisdiction

I pass over the question whether a party has standing to raise a question of the amenability of another party to suit as a ground for resisting the amendment of a complaint seeking to add such party. I assume without deciding that defendants have an interest in the question entitling them to press it now.

[15] On the merits, defendants characterize the amended complaint as attempting to allege a double derivative suit (in fact under the relevant concepts these might be called quadruple derivative suits). They assert that it is conventionally held that a court must have jurisdiction over both the parent corporation and the subsidiary to adjudicate such a claim. It is of course well settled that in a standard double derivative action both the parent and subsidiary corporations are indispensable parties. *See* 13 Fletcher, Corporations, §5997; *Sternberg v. O'Neil*, Del.Supr., 550 A.2d 1105, 1124 (1988); *Levine v. Milton*, Del.Ch., 219 A.2d 145, 156 (1966). The presence of the subsidiary is thought to be necessary so that the court's judgment may bind it; so that defendants' satisfaction of a judgment will authoritatively release the defendant; and for the less significant purpose that subsidiary may receive any recovery on its behalf.[11]

Here defendants claim that there can be no ground for asserting jurisdiction over these French "entities" and therefore there can be no double (or quadruple) derivative claim litigated. This assertion raises complex questions because the entities that plaintiff allege were used to enrich the fiduciary are creations of French law. No party has sought to inform the record to any extent concerning what the legal status of such companies may be under that law. The parties appear to assume that these businesses are essentially like corporations under Delaware law. That is, that it makes sense under French law to talk about a claim of wrong "owned" by the "corporation" that may be asserted by a "shareholder" under some set of circumstances, but that something like the pre-suit demand rule of Rule 23.1 also pertains. *E.g.*, defendants say that Carlton should first make a demand on the subsidiary's "board" (or perhaps all three levels of subsidiaries' "boards"). I have no real basis on this motion to assume anything about the relevant law of France. Since I cannot know what are the characteristics, rights, duties or governance rules concerning a French corporation, I will, for purposes of this motion,

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[11] I call this less significant because there are easily imagined alternatives that could solve this problem.

treat the French assets as held by TLC Beatrice (as allegedly they beneficially were).

On this assumption the matter becomes simpler, for the claim is simply *that a fiduciary caused a number of complex transactions to occur which financially injured his corporation (TLC Beatrice), albeit in an indirect way, for the purpose and with the effect of enriching himself.* At this stage it appears to me wholly unnecessary (and indeed not possible) to analyze these allegations as a flawed "double derivative" or "quadruple derivative" suit. If the facts alleged were proven to be true, can it be that the wrong proven cannot be remedied because the wrongdoer inflicted the injury through a foreign transaction, using foreign contracts or entities? Perhaps so, but I am not prepared now to so rule.[12]

At least for purposes of assessing the adequacy of the pleadings, I conclude that these facts, which may be characterized as a quadruple derivative claims, also constitute direct claims of TLC against Mr. Lewis, which may be litigated derivatively by its shareholders.

2. *Allegations of demand futility*

First, I reject as unproven by its proponents the assertion that one must make prior demand upon the board of a French enterprise of the sort involved here before instituting a double (etc.) derivative suit in this court. I cannot assume that these French enterprises are legal entities governed by the same rules as those that govern Delaware corporations. Second, in light of the determination that these claims can be brought as direct claims by TLC Beatrice and derivatively by Carlton, allegations that demand on the French subsidiaries would be futile serve no purpose. For these claims Carlton need only establish the futility of making a demand on the TLC Beatrice board; a requirement that defendants have not here challenged.[13]

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[12]Given the fact that all of these subsidiaries are 100% owned the only persons with a possible financial stake in the adjudication of these claims, other than the shareholders of TLC Beatrice, would be creditors of the various levels of French subsidiaries. Their interest would become more "real" the closer to insolvency those entities may be. I leave all of this for another day, however, as it is not a subject to be dealt with on this motion to amend.

[13]Apparently, defendants have conceded, by not challenging it in their original motion to dismiss, that demand would have been futile with respect to the claims in Carlton's original complaint.

3. Sufficiency of the allegations

Finally, the defendants argue that Carlton should not be permitted to add these claims because the allegations are "conclusory in nature and contain no particularized allegations as required by Court of Chancery Rule 9." They say that Carlton has not indicated "how Lewis allegedly exercise dominion and control over TLC Beatrice's subsidiaries, which subsidiaries' checkbooks were allegedly subject to Lewis's control, how much and when subsidiary funds were siphoned, or how Lewis was able to obtain a FF 55 million profit from the sale of Maxime." According to the defendants, Carlton is relying on suspicion and speculation to try to discovery a cause of action.

As a threshold matter, the particularity requirement of Court of Chancery Rule 9(b) is not applicable to the allegations concerning the French subsidiaries. Carlton's Second Amended Complaint indicates that these allegations pertain to claims of breach of fiduciary duty, not fraud. *See Desert Equities, Inc. v. Morgan Stanley Leveraged Equity Fund II, L.P.*, Del.Supr., 624 A.2d 1199, 1207 (1993) (holding the "fraud" is distinct from "bad faith" and declining to extend the pleading requirements of Rule 9 to averments of bad faith). Thus, defendants' arguments amount to a Rule 12(b)(6) assertion that Carlton's allegations generally fail to state a claim upon which relief can be granted.

[16] To avoid dismissal at the pleading stage, Carlton only needs to allege enough factual information to permit an inference that the charges may be correct and put the defendants on notice of the claims. *See Stotland v. GAF Corp.*, Del.Ch., C.A. No. 6876, Longobardi, V.C. (Mar. 24, 1983), Mem. Op. at 9-10; *Weinberger v. UOP, Inc.*, Del.Ch., 409 A.2d 1262, 1263-64 (1979) (both stating that there must be some allegations of specific facts from which to infer that the pleaded conclusions are correct). In my view, Carlton's allegations are legally sufficient; Carlton has pleaded specific facts, that if proven true, would establish potential claims of breach of fiduciary duty on the part of Lewis.

For instance, it is alleged that Lewis caused a subsidiary to sell Maxim Delrue to a related party and that the related party sold Maxim Delrue for over three times that amount just two months later. The allegations also spell out the nature of the loan that Lewis allegedly had forgiven and the consideration received (which Carlton contends was inadequate). These allegations describe the particular transactions challenged and are more than conclusory statements that Lewis was self-dealing. Moreover, if true, the allegation that Lewis took control of the bank accounts, made himself a signatory, and diverted funds to his

personal use, would certain establish a potential claim for beach of fiduciary duty.

D. Disclosures concerning Lewis's health

Carlton's Second Amended Complaint alleges that Lewis and TLC directors, Jean Fugett and Leslie Lewis knew but failed to disclose to the TLC Beatrice board that Mr. Lewis was suffering from an inoperable brain tumor (and would soon be retiring from his position as CEO) at the time the board voted to approve Lewis's compensation package in December 1992. Defendants assert that such allegations fail to state a cause of action upon which relief could be granted because (1) "[t]here is no evidence that anyone believed that Lewis was terminally ill or that his death was imminent at the time the Board approved payment of the Lewis compensation package," and (2) "there is no basis to conclude that Lewis's health was or would have been material to the Board's decision to approve payment of the compensation package" because the company had already taken on the obligation back in 1990, the payment was not contingent on Lewis's health, and the board was only voting in 1992 on which to pay all of it that year for tax reasons.

[17] Under the liberal test for construing the adequacy of pleadings, I must conclude that a valid claim has been stated. The complaint alleges that Lewis died in January of 1993 and that at the December 24, 1992 special meeting of the board one month earlier, Fugett informed the board that Lewis could not attend because he was "ill," that Fugett (as well as Lewis and Leslie Lewis knew but did not disclose that Lewis's condition was terminal, and that questioning about the extent of Lewis's illness was "shut off" by the Lewis family. These allegations that Lewis, Jean Fugett, and Leslie Lewis knew Lewis was terminally ill need not be any more specific; a party is only required to plead knowledge generally. *See Wells Fargo & Co. v. First Interstate Bancorp.*, Del.Ch., C.A. No. 14696, Allen, C. (Jan. 18, 1996)(observing that Rule 12(b)(6) and Rule 9(b) are very sympathetic to plaintiffs on the question of pleading knowledge).

Likewise, I cannot conclude based on the complaint alone that Lewis's health was immaterial to the board's December 1992 decision as a matter of law. According to the complaint, Lewis's compensation package was approved on December 19, 1990, but was specifically subject to the obtainment of the necessary consents or amendments required by the Stockholders' Agreement, consents Lewis never received. Thus, accepting the well-pleaded allegations as true, on December 24, 1992, the board was not yet obligated to pay Lewis this compensation. The matters alleged may arguably have been material to the board's

informed decision and thus satisfies the liberal pleading standards applicable to this motion.

IV. Undue delay and prejudice

[18-19] Having found Carlton's allegations to be legally sufficient, leave to amend their complaint should be granted unless there is a showing of substantial prejudice. *See Kahn Brothers & Co. v. Fischbach Corp.*, Del.Ch., C.A. No. 8987, Allen, C. (Sept. 19, 1989). Despite defendants' assertions to the contrary, they have not made such a showing.

A. Carlton's new claims

Defendants contend that they will suffer substantial prejudice if Carlton is permitted to add the new claims because (1) Carlton knew of the facts underlying its claims for years and waited to bring them until now for tactical reasons and (2) defendants will be subjected to more burdensome discovery, including the retaking of depositions.

Although defendants suggest that public filings disclosed the facts underlying Carlton's newly proposed allegations, the undisputed facts in the record do not establish that such filings were adequate to notify Carlton that these claims existed.[14] Rather, it seems that material facts underlying these claims arose during discovery.

In addition, defendants' fear of repetitive discovery does not present justification to deny Carlton's motion in these circumstances. Unlike the cases defendants rely on for the prejudicial effect of additional discovery, the parties here are not at the eve of trial but are still in the midst of their discovery efforts.[15] To be sure, Carlton's additional allegations will further complicate and expand the scope of this litigation, possibly requiring defendants to respond to additional discovery requests and witnesses to be redeposed. But Rule 15 adopts a permissive approach toward amending pleadings during pretrial discovery and the additional burden here is not significantly greater than it would have been

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[14]Arguably, these disclosures did not indicate: (1) that Lewis retained an irrevocable proxy over 750,000 shares of common stock; (2) that Lewis' statement to the board that he resigned from Lewis & Clarkson was incomplete in that he continued to participate in firm receipts; (3) that Fugett and Leslie Lewis concealed Lewis's terminal illness from the board when it voted on the compensation package, and (4) that Lewis took control of the French subsidiaries' checkbooks.

[15]Discovery efforts by both parties are currently scheduled to be completed by August 15, 1996.

had these allegations been made in the original complaint. These new claims are not wholly unrelated to the claims put forth in the original complaint and many arise from the same course of conduct; considerations of efficiency would suggest that they be tried and disposed of together.

B. The addition of Guarino and Wright

With respect to Carlton's proposed addition of Kevin Wright and David Guarino as defendants, defendants again contend that Carlton has long been familiar with these individuals and their roles at TLC Beatrice and has unduly delayed in attempting to add them. They point out that Wright was deposed by Carlton back in March 17, 1995. They also suggest that Wright will be prejudicated because his interests have not been represented in the litigation so far and he will be facing a short August 15 discovery cutoff date.

Although Carlton argues in its brief that its delay in adding these defendants was due to their unavailability for depositions, Carlton does not indicate what if any information was learned in discovery that led them to add these defendants. But even assuming Carlton delayed in adding these two defendants, it is hard to see how these defendants would be substantially prejudiced. In fact, defendants have not argued that Guarino would be prejudiced at all. Defendants also do not demonstrate how Wright's interests would have been substantially different than theirs, or cite instances in which his interests were not adequately represented. Because this litigation is still in the early stages and because these two defendants' interests would appear to be in alignment with the existing defendants, I do not find they will be substantially prejudiced by their joinder at this time.

* * *

For the foregoing reasons the motion to file a second amended complaint is granted.

CARLTON INVESTMENTS v. TLC BEATRICE INTERNATIONAL HOLDINGS, INC.

No. 13,950

Court of Chancery of the State of Delaware, New Castle

March 15, 1996

The plaintiff, Carlton Investments, and defendants, including TLC Beatrice, collectively brought motions to compel discovery under Court of Chancery Rule 37 in connection with this shareholder derivative action. Plaintiff brought one motion and defendants brought three.

The court of chancery, per Chancellor Allen, granted Carlton's motion to compel discovery. The court denied defendants' first two motions to compel and granted defendants' third motion to compel discovery.

1. Pretrial Procedure ⟹ 34
   Witnesses ⟹ 222

Defendant corporation's attorney-client privilege may not properly be invoked in a derivative action where plaintiff owns approximately twenty-two percent of the defendant corporation's stock; where plaintiff's main claim appears colorable; where what the discovery plaintiff seeks does not relate to advice concerning the litigation itself; where the information is not available from other sources; and where there is no risk that trade secrets or other proprietary business would be revealed.

2. Pretrial Procedure ⟹ 246

Plaintiff stockholder is not obligated, pursuant to an interrogatory request, to examine the files of its former general partners nor of its current and former limited partners because these entities or people are not agents of the plaintiff or within the plaintiff's control for purposes of discovery — even if some of them are directors on the board of plaintiff's sole general partner.

3. Pretrial Procedure ⟹ 271

Where a defendant, serving interrogatories inquiring about the factual basis of plaintiff's claims, admits familiarity with the universe of

documents in the case, but contends there is no support for plaintiff's allegations in those documents, the interrogatories are considered the equivalent of contention interrogatories to which a blanket reference to the documents produced is not sufficient.

4. Pretrial Procedure ⟹ 271

Contention interrogatories are specifically permitted by Court of Chancery Rule 30(b) and serve the useful purpose of narrowing issues for trial. Contention interrogatories are an appropriate means of obtaining a specification of the facts upon which a claim is founded. DEL. CH. CT. R. 30(b).

5. Pretrial Procedure ⟹ 271

A party should not be precluded from presenting a claim at trial because of the inability to set forth facts underlying such a claim in response to a contention interrogatory before that party has had a chance to conduct discovery to determine the facts. Rule 30(b) specifically permits the court to defer the answer to a contention interrogatory until sufficient discovery has been completed or permits the court to allow a party to answer such an interrogatory based only upon its present knowledge.

6. Pretrial Procedure ⟹ 301

To the extent that plaintiff's officers, employees, and general partner have personal information of oral communications that relate to the challenged transaction, the answers to the interrogatories should identify such communication, even if those officers are scheduled for future depositions.

7. Pretrial Procedure ⟹ 96, 301

To the extent that former general partners have knowledge of oral communications relating to the challenged transaction, the defendant will have to obtain that information by deposing such persons directly.

8. Pretrial Procedure ⟹ 358

Communications made between a plaintiff and accountants who are working for plaintiff's attorneys after the commencement of litigation,

and made for the purposes of such litigation, are protected by the work product doctrine.

9. Pretrial Procedure ⟹ 352, 353

Documents concerning plaintiff's investments with entities other than the defendant corporation which may contain similar terms to those contained in the agreement between plaintiff and defendant and may shed light on the parties' intent are nonetheless not relevant for purposes of discovery and not reasonably calculated to lead to admissible evidence.

10. Pretrial Procedure ⟹ 352, 355

Where defendant claimed that identification of plaintiff's limited partners may be relevant to its defenses of acquiescence, waiver, and estoppel, the plaintiff was required to identify its limited partners. Although such information was marginally relevant, the burden to produce it was minimal.

11. Pretrial Procedure ⟹ 352

Plaintiff must provide documents concerning its relationship with its financial advisor, where such documents are relevant to the defendant's opportunity to establish that plaintiff and its financial advisors were so intertwined that they were in reality a single entity, and that notice to the employees of the financial advisor of the facts underlying the challenged transaction constitutes notice to plaintiff.

12. Pretrial Procedure ⟹ 475

Plaintiff is not obligated to admit the truth of facts asserted in a request for admissions where the requests are based on facts within the exclusive control of defendant and the evidence of the truth of such matters is dependent on defendants' witnesses.

13. Pretrial Procedure ⟹ 171, 181

Plaintiff's former general partners who do not serve on the board of their current general partner are not proper Rule 30(b)(6) designees of plaintiff or the plaintiff's current general partner.

14. Pretrial Procedure ⟹ 171, 181

In response to a Rule 30(b)(6) deposition notice, a plaintiff is not rigidly obligated to produce the most knowledgeable person.

15. Pretrial Procedure ⟹ 358

Not every document created by an attorney is privileged, including those documents that appear to be communications regarding solely business matters from one business person to another through an attorney.

16. Pretrial Procedure ⟹ 358

A plaintiff has a legitimate expectation of confidentiality in documents drafted by members of their team of advisors with respect to litigation with a defendant. Such documents are privileged; the plaintiff is not required to produce them.

17. Pretrial Procedure ⟹ 358

Plaintiff is required to produce a memorandum which bears a stamp indicating it is confidential and attorney work product written by an unidentified individual to plaintiff concerning business related matters, where the memorandum itself appears to be solely business information and, even if it was prepared by an attorney, one cannot know who may have seen it.

Rodman Ward, Jr., Esquire, Cathy L. Reese, Esquire, and Herbert W. Mondros, Esquire, of Skadden, Arps, Slate, Meagher & Flom, Wilmington, Delaware, for plaintiff Carlton Investments.

Michael D. Goldman, Esquire, and Stephen C. Norman, Esquire, of Potter Anderson & Corroon, Wilmington, Delaware; Gregory V. Varallo, Esquire, and Matthew E. Fisher, Esquire, of Richards, Layton & Finger, Wilmington, Delaware; Henry E. Gallagher, Jr., Esquire, of Connolly, Bove, Lodge & Hutz, Wilmington, Delaware; David J. Margules, Esquire, of Wolf, Block, Schorr and Solis-Cohen, Wilmington, Delaware; David C. McBride, Esquire, and William D. Johnston, Esquire, of Young, Conaway, Stargatt & Taylor, Wilmington, Delaware; William M. McErlean, Esquire, Richard S. Huszagh, Esquire, and John F. Verhey, Esquire, of Rudnick & Wolfe, Chicago, Illinois, of counsel; and Thomas P. Puccio, Esquire, New York, New York, of counsel, for defendants.

ALLEN, *Chancellor*

MEMORANDUM OPINION AND ORDER

I am here required to call the balls and strikes of multiple discovery disputes in an apparently hard-fought litigation. Presented for decision are four motions to compel discovery under Rule 37 of our rules. One motion is brought by plaintiff, Carlton Investments. The others are brought by one or more of the defendants. All four motions along with Carlton's motion to amend the complaint were presented on March 11, 1996. This memorandum opinion and order reports my decision on the pending discovery motions. I continue to reserve decision on plaintiff s motion to amend.

I. Background

Carlton Investments, which allegedly owns approximately 22 percent of the outstanding common stock of TLC Beatrice, filed this stockholders' derivative action on January 4, 1995, seeking recovery of amounts allegedly paid by TLC Beatrice to or on behalf of the late Reginald Lewis, who is alleged to have been a controlling shareholder of TLC Beatrice. The defendants are the Estate of Reginald Lewis; various individuals who serve or served as directors of TLC Beatrice; TLC Transport, Inc., a wholly owned subsidiary of TLC Beatrice; several companies owned by Lewis but alleged to have participated in or benefitted from the misappropriation and waste; and TLC Beatrice, the beneficiary of the action.

The complaint alleges, among other things, that Lewis breached his fiduciary duties to TLC Beatrice and its minority stockholders, and misappropriated and wasted corporate assets by causing the company to enter into certain transactions between 1988 and 1992. As alleged, these transactions include causing the company to:

> (1) pay him, weeks before his death from a known but undisclosed brain tumor, $22.1 million, which included the reimbursement of $2.6 million for legal fees incurred by Lewis in an action unrelated to TLC Beatrice;
>
> (2) pay him millions of dollars in undocumented "living expenses";

(3) make improper payments to TLC Group, L.P., a limited partnership owned by Lewis and his daughters' trust, including the payment of salaries, bonuses, and severances for employees of TLC Group, L.P., the reimbursement of TLC Group, L.P. for various expenses, including payments of taxes and governmental levies for other Lewis-owned entities, payments to trusts for the benefit of Lewis' daughters, payments to affiliated law firms on matters unrelated to TLC Beatrice, and payments to McCall Pattern Holdings;

(4) pay rent for office facilities for Lewis-owned entities;

(5) lease, purchase, and maintain a corporate jet largely for the personal use of Lewis; and

(6) redeem the company's preferred stock so Lewis could cash out his shares.

This suit follows Carlton's filing of an individual action in the state of New York against TLC Beatrice and the Lewis Estate that sought recovery of approximately $11 million for alleged breaches of a stockholder agreement signed by Lewis, Carlton, and TLC Beatrice. In particular, Carlton challenged, in that suit, the propriety of the $22.1 million compensation package, arguing that under the stockholders' agreement the payments to Lewis trigger a right to proportionate payments to Carlton.

Shortly after this Delaware litigation was initiated, TLC Beatrice filed a motion to dismiss or stay the litigation and to stay discovery on several grounds, including the existence of the prior pending New York suit. Defendants' motion to stay discovery was granted only in part and Carlton continued its discovery efforts. On November 21, 1995, the court issued an opinion denying defendants' motion to dismiss or stay and shortly thereafter defendants began their discovery.

II. Carlton's motion to compel

On December 21, 1995, plaintiff Carlton filed a motion to compel discovery. First, plaintiff seeks to compel TLC Beatrice and the Lewis Estate to produce certain documents that TLC Beatrice identified on its privilege logs as withheld on the grounds of privilege. Second, plaintiff seeks an order overruling defendants' objection to certain questions asked

of Thomas Lamia, former counsel for defendants TLC Beatrice and Reginald Lewis, on lawyer-client privilege grounds. Specifically, plaintiffs want Mr. Lamia to answer questions regarding any advice he or his law firm gave to TLC Beatrice concerning: (i) the Stockholders' Agreement between Lewis, Carlton, and TLC Beatrice; (ii) Lewis' compensation; (iii) reimbursement of Lewis' expenses in the McCall litigation; and (iv) the stock appreciation rights awarded to TLC Beatrice's directors.

Carlton concedes that most of the requested documents as well as the advice given by Mr. Lamia qualify for protection as privileged at the behest of TLC Beatrice, but claims that TLC Beatrice's attorney-client privilege may not properly be invoked in this derivative action as plaintiff has demonstrated good cause not to do so. *See Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970), *cert. denied*, 401 U.S. 974 (1971); *Valente v. Pepsico, Inc.*, 68 F.R.D. 361 (D. Del. 1975); *Deutsch v. Cogan*, Del. Ch., 580 A.2d 100 (1990). In the event the court determines that there is not good cause to overcome the attorney-client privilege, Carlton suggests that by selectively disclosing some of the advice they received from counsel, the defendants waived the privilege with respect to all advice received regarding the compensation of Lewis.

As an initial matter, with respect to Mr. Lamia's advice, defendants claim that Mr. Lamia represented TLC Group, L.P., not TLC Beatrice, at the time the Stockholder's Agreement was negotiated. Also, at argument the Estate of Lewis argued that some of Lamia's communications with Lewis may have been made in connection with his personal representation of Lewis. To the extent that either of these situations may have been the case, defendants say that Carlton cannot argue good cause to invade a privilege not belonging to TLC Beatrice.

Nonetheless, the record indicates that Lamia did not represent Lewis as an individual after 1980. Moreover, during the time of the alleged transactions it is not clear which exact entities Mr. Lamia was representing and which entities were paying him at what times. His retention agreement was with TLC Beatrice. I cannot conclude that any advice Lamia gave during the time period of the acquisition of the international assets of Beatrice was presumptively as advisor to TLC Group.

[1] In comparison to the uncertainty as to who, other than TLC Beatrice, Lamia might have been representing, the shareholders of TLC Beatrice, on whose behalf this action was brought, have a legitimate interest in access to the information sought here. Consideration of the factors spelled out in *Garner v. Wolfinbarger* convince me that it is not appropriate here to preclude Mr. Lamia from disclosing relevant

information; Carlton owns approximately 22% of TLC Beatrice's stock; at least its main claim appears colorable; the discovery it seeks does not relate to advice concerning the litigation itself; the information is not available from other sources; and there is no risk that trade secrets or other proprietary business information would be revealed. Thus, defendants' objection to certain questions asked of Mr. Lamia on privilege grounds is overruled. Likewise, Carlton has shown good cause for overriding the attorney-client privilege in this derivative litigation with respect to the documents it has requested on TLC Beatrice's privilege log and is entitled to the production of those documents.[1]

III. Defendants' first motion to compel

On February 13, 1996, defendant TLC Beatrice filed a motion to compel seeking: 1) to compel Carlton to supplement its responses to TLC Beatrice's First Set of Interrogatories; 2) to compel Carlton to produce all non-privileged documents responsive to TLC's First Request for Production of Documents; 3) to deem as admitted Request Nos. 15, 19, 20, 21 and 28 of TLC Beatrice's First Request to Admit; and 4) to compel Carlton to provide a log of documents withheld on the basis of privilege. Carlton's privilege log was subsequently provided to the defendants, but some of the documents listed are now the subject of a subsequent motion to compel discussed in Part V.

1. The responses to TLC Beatrice's interrogatories

Through interrogatories served upon Carlton on December 8, 1995, TLC Beatrice sought to determine, *inter alia*: (1) the basis and factual support for Carlton's claims; (2) when and to what extent Carlton and its partners had knowledge of the challenged transactions; (3) the basis for Carlton's claimed ownership interest in TLC Beatrice; and (4) what oral

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[1]Some of these documents reflect business dealings of TLC Transport, Inc., a wholly-owned subsidiary of TLC Beatrice, and therefore arguably the privilege could run to TLC Transport rather than TLC Beatrice. However, defendants have made no claim that these documents are privileged documents of any entity other than TLC Beatrice. It is also questionable whether these documents could even be subject to a privilege of TLC Transport because to the extent these documents reflect privileged communications they are communications to or from Kevin Wright, counsel to TLC Beatrice. For these purposes, and without addressing whether TLC Beatrice's maintenance of these documents could constitute a waiver of the privilege, I simply note that, even if some of these documents could be considered privileged documents of TLC Transport, the *Garner* factors as applied to the particulars of this case convince me that it would be appropriate to allow Carlton access to such documents.

and written communications transpired between the partners of Carlton, Carlton, and Mr. Lewis related to the challenged transactions.

First, TLC Beatrice claims that Carlton's responses to these interrogatories were inadequate because they did not even purport to set forth facts within the knowledge of Carlton's *former general partners* and *its current and former limited partners* relating to the issues in the lawsuit. Some of Carlton's former general partners, it is claimed, are now on the board of directors of Carlton's current general partner, CS Manager, Corp. Defendant TLC Beatrice surmises that Carlton "made no effort whatsoever to examine the files of its former general partners (most of whom are now limited partners or on the Board of Directors of CS Manager) or the files of its current and former limited partners, or to consult those individuals regarding its responses to the Interrogatories."
[2] It is acknowledged that Carlton has searched its files and the files of its sole general partner, CS Manager, and has provided TLC Beatrice with all the information within the knowledge of CS Manager. In my opinion, Carlton is not obligated to examine the files of its *former* general partners nor of its current and former limited partners. These entities or people are simply not agents of Carlton or within the control of Carlton for purposes of discovery — even if some of them are directors on the board of CS Manager. Under these circumstances, asking interrogatories of Carlton is not the appropriate method of getting this information, there are other direct processes available and, in fact, defendants have already noticed these former general partners for depositions.

TLC Beatrice next claims that Carlton's responses to certain interrogatories (interrogatories asking about the factual bases for Carlton's claims and the oral communications that took place between Carlton, its partners, and Lewis) were inadequate because, in lieu of providing specific answers, the responses referred TLC Beatrice indiscriminately to the entire production of documents as well as to depositions taken and to be taken.

With respect to the factual bases underlying the allegations of the complaint, Carlton says that its complaint specifies which documents pertain to which claims. TLC Beatrice, on the other hand, admits that it is familiar with the universe of documents, but contends that the documents contain no information responsive to the interrogatories.
[3-5] This is therefore not a situation, as contemplated in Rule 30(c), in which one party would be burdened with sifting through a mass of documentation when the other party could easily direct them to particular documents. Rather, defendants here admit familiarity with the documents but contend there is no support for Carlton's allegations in those documents. In these circumstances, these interrogatories are the