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*Revisions are to pages 6, 10, 37, 40, 42, 45, 46, 52 and 54

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

WILLIAM M. STRASSBURGER, :

Plaintiff,

v. C.A No. 14267

MICHAEL M. EARLEY, LUTHER A. HENDERSON, JOHN C. STISKA, N. RUSSELL WALDEN, and TRITON GROUP, LTD., a Delaware corporation, : :

Defendants,

and

RIDGEWOOD PROPERTIES, INC., a Delaware corporation, :

Nominal Defendant. :

OPINION

Date Submitted: September 24, 1999
Date Issued: January 24, 2000
Dated Revised: January 27, 2000*

Craig B. Smith and Charles E. Butler, Esquires, of SMITH, KATZENSTEIN & FURLOW LLP, Wilmington, Delaware; Attorneys for Plaintiff

Stephen E. Jenkins, Esquire of ASHBY & GEDDES, Wilmington, Delaware; Phillip S. McKinney, Esquire, or ROGERS & HARDIN, Atlanta, Georgia; Attorneys for Defendant Luther Henderson and Nominal Defendant Ridgewood Properties, Inc.

Triton would be giving increased attention to its Ridgewood investment, from which Triton hoped to realize $13 million to $16 million in value over the next two years.[7] Shortly thereafter, Stiska and Earley asked Walden to prepare a plan that would "get Triton out of Ridgewood within two years -- by liquidation, sale or whatever."[8]

None of these developments came as a surprise to Walden, who had been closely following Triton's financial problems for some time. Walden had every reason to be concerned about Triton's continued majority stock investment in Ridgewood: Walden's Ridgewood stock represented 65% of his net worth. Furthermore, he depended on Ridgewood for his livelihood. Walden's compensation package included a $200,000 annual salary, company-financed insurance policy and a private club membership, a post-employment contract that would pay his salary for a specified period, and a supplemental retirement plan that would pay him $100,000 annually for life, plus cash bonuses. As time went on, Walden became concerned that Triton's financial problems would cause Triton either to liquidate Ridgewood's assets or sell its controlling interest in Ridgewood to a "bone picker" short term investor that would liquidate Ridgewood at "fire

[7]JTX 3 at7.

[8]JTX 5; Trial Transcript ("Tr.") at 313.

self-tender by Ridgewood for its own shares. That alternative does appear to have been discussed, but whether it was formally considered by all the directors meeting collectively as a board is not clear.[13] Be that as it may, the evidence shows that Triton favored this form of transaction because it would provide Triton with immediate cash yet still allow Triton to continue its large equity participation in Ridgewood. A self-tender would, moreover, afford liquidity to all shareholders on an equal (pro rata) basis. That alternative was rejected, nonetheless, because in Walden's view, "such an approach...[would not] accomplish one of the goals that management had in mind, which was eliminating the overhang of the 74 percent shareholder."[14]

The fourth and final alternative the Ridgewood board considered was a cash dividend to all Ridgewood shareholders. That approach, like the self- tender, would deliver cash to all shareholders on a pro rata basis. Triton also favored this alternative because it would provide Triton with cash yet allow Triton to maintain its controlling equity position in Ridgewood. This alternative was also rejected because Walden was unwilling to approve any transaction that did not eliminate

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[13] Although the defendants quote Earley's and Henderson's views on that issue, they omit reference to Henderson's testimony that he did not recall a specific discussion of this alternative with Walden, Stiska or Earley about this subject. JTX 55 at 71-75, 79.

[14] Tr. at 257; see also, JTX 15; Tr. at 68,210, 257, 282.

interests at Ridgewood's expense, he would have advocated a cash dividend, that would have netted him $1.2 million personally while enabling him to continue on as Ridgewood's CEO.[41]

If credible, that testimony would constitute a valid defense to the entrenchment claim. The difficulty is that the testimony is not credible, not only because it is self-serving but also because it does not square with the objective facts.

First, the evidence does not support the contention that the board seriously considered the alternatives to a repurchase, and to the extent alternatives were (in fact) raised, they were quickly brushed aside because Walden disfavored them. As previously discussed, the first alternative -- a spin off of Triton's Ridgewood shares -- was supposedly considered by the Ridgewood board and then proposed to Triton, which rejected it because the Triton stockholder base was too large to allow a meaningful distribution of Triton's Ridgewood shares. But that scenario is nowhere documented in the record, and defendants do not explain why the board did not consider an immediately obvious solution to this supposed problem:

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[41]The defendants also argue that Walden's (brief) termination of negotiations with Triton on May 18, 1994, and his consideration of other possible uses of Ridgewood's cash, negates the argument that his objective was to seek a transaction that would catapult him into a position of control.

a crisis that threatened the ongoing viability of the Company, and that was so grave as to outweigh these negative business concerns, might arguably justify a repurchase of control.[44]

Had the board voted to repurchase only the Triton shares, that at least would have been consistent with defendants' claim that they were motivated only by a desire to protect the Company and its minority stockholders from "bone pickers." But the repurchase of Hesperus's shares fatally undercuts this rationale, because Hesperus held only 9% of Ridgewood's stock. It did not own control and it did not pose any threat to the enterprise. There was no need to buy back Hesperus's stock to eliminate a potentially threatening controlling stockholder. The buyout of Triton's shares was sufficient to accomplish that. Given Ridgewood's shaky financial condition, a prudent businessman-fiduciary would spend not one penny more than was necessary to acquire Triton's controlling interest. Once Triton's control block was acquired, a further expenditure of $1.45 million to acquire Hesperus's 9% block would accomplish nothing except to further deplete Ridgewood's badly needed working capital. I conclude, for these reasons, that a repurchase of Hesperus's shares could further only one purpose -- to confer

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[44] Delaware case law would support a repurchase of control in such circumstances. See Unocal, 493 A.2d at 954-55; Cheff, 199 A.2d at 555.

"primarily in the corporate interest."[45]

That this finding properly flows from these adjudicated facts is most graphically illustrated by Potter v. Sanitary Companv of America.[46] In Potter (as here), the corporation (Sanitary Company), was majority-owned by another company (Consolidated), which had placed its designees on Sanitary's board. Two of those board members, Keenan and Brewer, whose group also controlled Consolidated, had accumulated substantial stock in Sanitary. Although Sanitary (like Ridgewood) was in financially straitened circumstances and could ill afford the expense, these directors caused Sanitary to repurchase Consolidated's controlling stock interest. The effect was to enlarge the Keenan-Brewer group's holdings to a "safe majority." There, as here, the directors argued that the repurchase was done for non-control related business reasons, namely, because the company needed to have common shares available to pay a bonus on its preferred stock. Rejecting that argument, the Chancellor observed:

> "Why, in view of the reduced state of Sanitary's business, the necessity of curtailment of expenses all around..., and the daily progress of its losses, did its officers reduce its cash position by another twenty-five hundred dollars laid out in the purchase

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[45]Bennett v. Propp, 187 A.2d at 409.

[46]Potter, 194 A.2d at 120.

negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained."[50]

Here, the board's decision to repurchase the Triton and Hesperus stock was triggered by Triton's announcement of its plan to exit its investment. The board's response to that announcement -- the repurchases -- was initiated by Walden, whose intense self interest in making that happen guided his conduct. To assure that the board would arrive at the specific outcome (structure) he desired, Walden subtly assumed control of the decision making process -- a feat that was not difficult to carry off because the remaining directors trusted Walden and followed his lead. In that sense the three relevant fair dealing factors -- initiation, structure and negotiation -- converged. The board, at Walden's initiation and urging, approved a transaction structure that would benefit only Walden and the two largest shareholders whose holdings were to be repurchased. Walden then negotiated with those two shareholders to obtain favorable price and other terms. Missing from the negotiating process and the board decision making process, however, was any independent representation of the interests of Ridgewood's minority public. stockholders. In those circumstances, there was no fair dealing,

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[50]Weinberger, 457 A.2d at 711.

because there was no advocate committed to protect the minority's interests, and because the players were either indifferent, or had objectives adverse, to those interests.

This failure of process explains, at least in part, why the Ridgewood board did not observe its duty to assure that the repurchases were fair to the corporation and its minority shareholders. The transactions were the functional equivalent of Ridgewood (a) purchasing the control block of its own stock for $8 million and then (b) transferring the repurchased block to a single shareholder without receiving any consideration in return. The fiduciary duty implications of such a transaction should have been apparent had the board members straightforwardly acknowledged that they were about to approve a gratis transfer of corporate control to a single stockholder -- Walden -- and as a result, leave the minority stockholders worse off than they were before.[51]

I therefore conclude that the repurchases are invalid for the additional reason that the defendants have not demonstrated that those transactions were

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[51]The corporation in which the minority stockholders were investors would have sold its only productive asset and would end up with $5 million in cash, a substantial portion of which would be subject to creditors' and dividend claims. Moreover, the likelihood that those shareholders would have an opportunity to liquidate their investment would be markedly lessened, because Ridgewood's new majority stockholder had strong financial incentives to remain in his control position and not put the Company up for sale.

particularly one involving publicly traded securities.[54]

For these reasons, the only Triton-related rescission remedy that can be granted is partial. That remedy would involve restoring to Ridgewood the Preferred Stock currently held by Triton's successor, which in mm would receive from Ridgewood, newly issued Ridgewood shares in an amount that would be equivalent in value to the Preferred Stock. The balance of the remedy must take the form of rescissory damages and other forms of equitable relief, for which reason I turn next to the rescissory damages question.

2. Rescissory Damages

The plaintiffs request for a rescissory damages award against the defendant directors is also problematic, although for different reasons. To explain why, it becomes necessary to explore the troublesome character of rescissory damages, and also the differing levels of culpability of the four defendant directors.

The traditional measure of damages is that which is utilized in connection with an award of compensatory damages, whose purpose is to compensate a plaintiff for its proven, actual loss caused by the defendant's wrongful conduct.

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[54] Ryan v. Tad's Enterprises, Inc., Del. Ch., 709 A.2d 682 (1996, aff'd, Del. Supr., 693 A.2d 1082 (1997); Patents Management Corp. V. O'Conner, Del. Ch., CA. No. 7710, Walsh, V.C., Ltr. Op. At 6 (June 10, 1985)(rescission of a merger that occurred three years before was "not a feasible remedy given the length of time that has elapsed since the merger."); see Gaffin v. Teledyne, Inc., Del. Ch., C.A. No. 5786, Hartnett, V.C., Mem. Op. At 49 (Dec. 4, 1990).

damages as "the monetary equivalent of rescission...which will, in effect, equal the increment in value that . . ..[the majority stockholder] enjoyed as a result of acquiring and holding the...stock in issue."[55]

Thereafter, in Weinberger v. UOP, Inc.[56] and in Cede & Co. v. Technicolor, Inc.,[57] the Supreme Court expanded the universe of defendants against whom rescissory damages could be awarded, to include corporate directors found to have breached their fiduciary duties in approving a self dealing merger. That expansion generated several questions, which include: in what specific circumstances will it be an appropriate exercise of discretion to award rescissory damages? Should rescissory damages be awardable against directors who vote to approve the transaction but who did not benefit from it? If so, is the directors' state of mind relevant, i.e., does it matter if the directors acted (a) in bad faith, or (b) in good faith but without appropriate due care?

These issues arose because of the problematic character of this form of money damage relief that potentially could include elements of value causally unrelated to the wrongdoing. In an article discussing rescissory damages in the

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[55] Lynch v. Vickers Energy Corp., Del. Supr., 429 A.2d 497,501, 505 (1981).

[56] 457 A.2d at 714.

[57] Del. Supr., 634 A.2d 345,372 (1993).