IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

JOHN G. BALLENGER, CHRISTOPHER J. BALLENGER., FREDERICK M. HENSCHEL, MICHAEL K. GAMMILL, JACQUELINE M. TWASTSTIJERNA and GLENN J. BALLENGER,	)	
Plaintiffs,	)	
	)	Civil Action No. 19399
v.	)	
APPLIED DIGITAL SOLUTIONS, INC., a Missouri corporation and COMPUTER EQUITY CORPORATION, a Delaware corporation,	)	
Defendants.	)	

MEMORANDUM OPINION

Date Submitted: April 19, 2002
Date Decided: April 24, 2002

Gregory V. Varallo, Peter B. Ladig, and Kelly C. Ashby, Esquires, of RICHARDS, LAYTON & FINGER, Wilmington, Delaware; Of Counsel: Phillip M. Goldberg, Esquire, of FOLEY & LARDNER, Chicago, Illinois, Attorneys for Plaintiffs.

P. Clarkson Collins, Jr., Esquire, of MORRIS, JAMES, HITCHENS & WILLIAMS, Wilmington, Delaware; Of Counsel: Rodney F. Page, Stephen S. Kaye, and Amy C. Shaw, Esquires, of BRYAN CAVE LLP, Washington, DC, Attorneys for Defendants.

STRINE, Vice Chancellor

This opinion resolves several motions in this case arising out of a merger between Computer Equity Corporation ("Compec") and defendant Applied Digital Solutions, Inc. In the merger, Compec was sold to Applied Digital. This litigation centers on whether Applied Digital complied with its post-closing duties to make certain eamout payments to Compec's selling stockholders, and to use its best efforts to register the Applied Digital shares paid to those selling stockholders as part of the initial merger consideration.

The plaintiffs — who represent the selling Compec stockholders — and defendant Applied Digital have both filed a variety of dispositive motions that lack any consistent theme capable of summary description. In the pages that follow, I deny all the dispositive motions.

I.

The parties to this action include plaintiffs John G. Ballenger, Christopher J. Ballenger, Frederick M. Henschel, Michael K. Gammill, Jacqueline M. Twaststijema, and Glenn J. Ballenger. Each of the plaintiffs is a former stockholder of Compec.

Defendant Applied Digital purchased Compec under a merger agreement dated June 30, 2000. The merger closed on August 1, 2000.

John Ballenger founded Compec, and he and members of his family owned 72% of Compec's shares before the consummation of the merger.

Before the sale, John Ballenger and fellow plaintiffs Christopher Ballenger and Henschel occupied top management positions at Compec. In the merger agreement, these three Compec stockholders were designated as the representatives for all the selling Compec stockholders (the "Compec stockholders") and given the authority to act on their behalf in contesting any alleged breach of the merger agreement. Hereinafter, these three plaintiffs are at times referred to as the Stockholders' Representatives.

II.

The Stockholders' Representatives and the other named plaintiffs have brought this suit to remedy perceived breaches of the merger agreement by Applied Digital. An expedited tial on the plaintiffs' claims is scheduled for July of this year. In advance of that date, the parties have filed several dispositive motions. The basic factual background relevant to those motions now follows.

In the merger, the Compec stockholders received initial payments of $8,987,000 in cash and $15,662,000 in Applied Digital stock in exchange for their Compec shares. After closing, Applied Digital also assumed certain additional obligations to the Compec stockholders.

For example, in a separate registration rights agreement, Applied Digital bound itself to use its best efforts to register as promptly as

practicable the Applied Digital shares received by the Compec stockholders at the closing of the merger.' Relatedly, Applied Digital was required to "piggyback" the Applied Digital shares received in the merger on any other registration the company was filing.[2] In Count III of their complaint, the plaintiffs allege that Applied Digital breached both of these obligations. In § VI of this opinion, I address Applied Digital's motion to dismiss Count III, and discuss the remaining facts regarding that motion therein.

The other major duty that Applied Digital assumed under the merger agreement was its obligation to pay the Compec stockholders up to two additional "Earnout" payments if Compec achieved certain financial results after the closing during two Earnout periods. The first covered the period between July 1, 2000 and June 30, 2001 (the "First Eamout Period"). Applied Digital was required to calculate whether the First Eamout payment was due to the Compec stockholders and to make any such payment on the earlier of(i) September 30, 2001 or (ii) the date 10 business days after the date on which the financial statements are completed and have been subjected to certain 'Agreed Upon Procedures . . .'"[3] The Agreed Upon Procedures simply mean that "the Eamout Financials will be prepared from

[1] Registration Rights Agreement §§ 2, 4.1 (Compl. Ex. B).

[2] *Id.* § 3.

[3] Merger Agreement § 1.05(a)(iii).

the books and records of the Surviving Company in accordance with GAAP, consistently applied and in accordance with Compec's accounting policies prior to the Merger."[4]

When September 30, 2001 came and went, however, Applied Digital did not make a First Eamout payment to the Compec stockholders. Nor did it provide them with Eamout Financials indicating that no Eamout was due.

Applied Digital's failure to do either was inconsistent with its then-current Securities and Exchange Commission Form 10-Q, which was filed on August 17, 2001 (the "August 200 1 1 O-Q"). In that filing, Applied Digital indicated that it had made an Eamout payment to the Compec stockholders of 14,732,200 shares of Applied Digital stock valued at $ 7.3 million. The August 200 1 1 O-Q reported that this was due to Compec's "achievement of earnings targets" for the First Eamout Period.'

Earlier in 2001, certain of the plaintiffs had sued Applied Digital in the United States District Court for the District of Delaware, alleging breaches of the federal securities laws in relation to, among other things, Applied Digital's failure to honor its duties under the registration rights agreement. After September 30, 2001 came and went without an Eamout

[4] Id. § 1.05(c).

[5] Aug. 2001 10-Q at 13, 35 (J. Ballenger Aff. Ex. C.)

payment being made, the plaintiffs in the federal action added a claim based on Applied Digital's failure to make the First Eamout payment.

During the pendency of that federal suit, Applied Digital filed its next 1 O-Q, which modified its prior disclosure. In a filing dated November 14, 200 1 (the November 200 1 1 O-Q), Applied Digital claimed that it had issued the $7.3 million worth of shares to the Compec stockholders, but had cancelled those shares before delivery because Applied Digital had "bec[o]me aware of information which called into question whether the earnings targets had in fact been met."[6] Without indicating definitively whether an Eamout payment was or was not due, Applied Digital simply said that it needed to conduct an investigation. Regrettably, Applied Digital's later disclosures have not always been consistent, with most tracking the November 2001 disclosure, but with at least one tracking the disclosures in the earlier August 2001 10-Q.[7]

Be that as it may, Applied Digital claims that its position is as set forth in the November 200 1 1 O-Q. Specifically, Applied Digital contends that it learned disturbing information in the late summer of 2001 that led it to suspect that the books of Compec were not accurate. When Applied Digital

---

[6] Nov. 2001 IO-Q at 14 (Def. Opp. To Pl. Mot. for Summary Judgment Ex. B.).

[7] See Feb. 11, 2002 Registration Statement Amendment at 11-4, n. 7 (J. Ballenger Aff. Ex. E).

attempted to get a handle on those inaccuracies, it contends it was faced with obstruction from Compec's then-existing management, which as of that time still included the Stockholders' Representatives, ***i.e.,*** plaintiffs John Ballenger, Christopher Ballenger, and Henschel. Because it could not get access to all the information it needed to verify Compec's financial statements, Applied Digital says it decided to halt the First Eamout payment because it was uncertain that any payment was due.

In October, 200 1, Applied Digital fired the Compec management team, including the Stockholders' Representatives. Thereafter, Applied Digital compiled what it now claims to be evidence that the earnings of Compec for the First Eamout Period were materially overstated by, among other things: 1) the failure to record the costs of hundreds of thousands of dollars of checks issued to fictitious vendors; 2) improper recognitions of revenue, failures to record certain expenses and to account for credits, and double counting a $400,000 revenue item, resulting in an earnings overstatement of over $1.6 million; 3) $1.3 million in recorded revenue which was not in fact received during the First Eamout Period; and 4) $800,000 in unrecorded vendor invoices.* Applied Digital attributes major portions of these problems to the Stockholders' Representatives.

---

[8] ***See Landers*** Aff. ***passim.***

Applied Digital contends that the effect of these adjustments is to reduce Compec's earnings for the First Eamout Period below the level at which any Eamout payment is due. It further avers that its work on the Compec financials for the First Eamout Period is continuing through no fault of its own, because the alleged mismanagement and malfeasance of Compec's former managers has continued to render it impossible to complete a final accounting.

In the face of the affidavit evidence supporting Applied Digital's arguments, the plaintiffs have been content solely to point to Applied Digital's SEC Form 10-K filed April 1, 2002, which covers the year ended December 3 1,200 1 (the "200 1 1 O-K"). In the 200 1 1 O-K, plaintiffs point out, Applied Digital makes the following references to Compec's performance for calendar year 200 1:

- "Approximately $2 1.3 million, or 7.7%, of our wholly owned subsidiary, Computer Equity Corporation's revenue during 2001 was generated through sales to the United States federal government ."
- "Our Telephony group's revenue increased $3.3 million, or 8.3%, from 2000 to 200 1. Computer Equity Corporation, a company acquired in June 2000, contributed $10 million of the increase offset by a decrease of $6.7 million from existing businesses due to a decrease in demand in the telecommunications market during 200 1."
- "Our Telephony group's profit declined $6.3 million, or 42.4%, from 2000 to 2002 . . . . Partially offsetting the

> decline in gross profit was an increase of $2.2 million from Computer Equity Corporation, a company acquired on June 1, 2000."[9]

From these and other provisions of the 2001 10-K, it is apparent that Applied Digital's financial statement for the year 2001 was based on profit and loss data for Compec. This financial statement was certified by Applied Digital's auditors, PriceWaterhouseCoopers ("PWC"), as being compliant with GAAP and materially accurate in all respects.

The clarity of PWC's opinion is, however, somewhat muddied by a note to the financial statement, which references the Earnout issue and the continuation of Applied Digital's investigation of whether Compec achieved its earnings target for the First Eamout Period." But, as plaintiffs point out, nowhere does the 2001 10-K indicate that Applied Digital suspects that Compec's financial statements were unreliable because they contained millions of dollars in errors due to purposeful misconduct on the part of its former management, which is the charge that Applied Digital has leveled in this lawsuit as a defense.

I will now discuss and resolve the flurry of motions before me.

---

[9] 2001 10-K at 7, 27, and 29 (respectively) (Goldberg Aff. Ex. A).

[10] Id. at F-22.

III.

The first motion I tackle is the plaintiffs' motion for partial summary judgment. That motion is premised on the notion that Applied Digital indisputably breached its contractual duties to (i) calculate the Eamout Financials in time to pay the Earnout no later than September 30, 2001; and (ii) pay the First Earnout by that date. According to plaintiffs, Applied Digital's publicly filed financial statements constitute an admission that it had the information necessary to set forth the Eamout Financials and that Applied Digital's own accounting of those Financials (as set forth in its August 2001 10-Q) required it to pay $7.3 million in stock to the Compec stockholders on September 30, 2001. In connection with that motion, plaintiffs seek mandatory injunctive orders to make sure that the Compec stockholders are not injured by any delay in payment, and reserve the right at trial to seek a higher Eamout. At the very least, plaintiffs contend, Applied Digital must be ordered to provide the Compec Stockholders' Representatives with the Eamout Financials required by the contract so that the plaintiffs may contest the company's calculation at trial.

The procedural standard that governs my disposition of the plaintiffs' motion for partial summary judgment is well-established and needs no lengthy recitation. Suffice it to say that the plaintiffs bear the burden to

show the absence of any material dispute of fact that would preclude entry of a judgment for them as a matter of law."

To meet their burden here, the plaintiffs rely solely on the public filings of Applied Digital, which they contend constitute a binding admission that the First Eamout payment of $7.3 million in Applied Digital shares was due to the Compec stockholders on or before September 30, 2001. Moreover, the plaintiffs argue that Applied Digital's 2001 10-K proves that there was no basis to Applied Digital's contention that it could not produce the Eamout Financials for the First Eamout Period as a result of supposed improprieties and obstruction by Compec's former management. How, plaintiffs ask, can Applied Digital produce a 10-K laden with positive statements about Compec's contribution to year 2001 results for the investing public and yet argue to this court that it still cannot generate accurate Eamout Financials for the First Eamout period?

The plaintiffs' argument is not without logical power. Nonetheless, it cannot sustain a motion for summary judgment. In its answering papers, Applied Digital has pointed to record evidence that would support a finding that the conduct of Compec's former management team — which was headed by one of and included all of the Stockholders' Representatives —

[11] Ch. Ct. R. 56(c); *Gilbert v. El Paso Co.*, 575 A.2d 1131, 1142 (Del. 1990).

made it impossible for Applied Digital to calculate the Eamout Financials accurately by the September 30, 2001 payment deadline." This record evidence also could support the inference that Applied Digital doubted as of the payment date that any Eamout payment was due for the First Eamout Period.

The plaintiffs' skepticism about whether Applied Digital continues to be able to generate final Eamout Financials for the First Eamout Period is not unreasonable, of course, given the statements in the 200 1 1 O-K and the lengthy period of time that has passed. During that period of time, Applied Digital has borne a contractual obligation to act with diligence to produce the required Eamout Financials. Whether or not it has fulfilled that duty, however, is a factual question that the present record does not indisputably answer. In this regard, I note that the plaintiffs have chosen to stand mute in the face of particularized allegations of accounting irregularities at Compec during the First Eamout Period. This silence has left me with no basis to find that Applied Digital's protestations have no triable basis in fact.

---

[12] Buttressing this factual showing is the hombook law that "he who prevents a thing being done shall not avail himself of the non-performance he has occasioned." *United States v. Peck, 102* U.S. 64, 65 *(1880); see also Mobile Comm 'ns Corp. of America v. MCI Comm 'ns Corp.,* 1985 WL 11574, at *4 (Del. Ch.) (same principle). The plaintiffs have not challenged this legal principle in their briefs, simply its factual applicability to this situation.

Furthermore, although Applied Digital's public disclosures are somewhat odd, even the 200 1 1 O-K places the reader on notice of the accounting investigation regarding Compec's performance during the First Eamout Period. The inconsistency that the plaintiffs see between Applied Digital's 2001 10-K and its position in this litigation is perhaps explainable on technical grounds. For example, it could be that the problems that Applied Digital argues make it impossible to calculate the Eamout Financials are material in terms of whether the Compec stockholders are entitled to an Eamout payment, but not in terms of the overall financial statements of Applied Digital. Whether or not that is the case must be determined at trial, because the record before does not answer that or other key factual questions in any indisputable manner.

Finally, although the August 200 1 10-Q appears to constitute an "admission" by Applied Digital that it owes an Eamout of $7.3 million for the First Eamout Period, its later filings retract that admission. In this respect, I agree with Applied Digital that the plaintiffs are confusing out-of-court statements of Applied Digital that are admissible as statements of a party-opponent[13] — *i.e.*, an "evidentiary admission" — with the sort of

[13] See DEL. UNIF. R. EVID. 80 1 (d)(2).

"judicial admission" that would bind Applied Digital to the fact admitted.[14] I expect that the plaintiffs will beat Applied Digital about the head with its prior public filings at tial in a fair display of litigation pugilism, and that these prior filings might buttress a post-trial decision in their favor? But these filings do not support entry of summary judgment?

IV.

Applied Digital has moved for dismissal or a stay of Count II of the plaintiffs' complaint because the claim allegedly must be arbitrated. Count II of the complaint alleges that an Eamout payment was due to the Compec stockholders on or before September 30, 2002, and that this court should determine after trial the exact Eamout figure and order Applied Digital to pay that amount, with appropriate ancillary relief to preserve the real economic value of that sum.

---

[14] For example, an admission of fact in an answer to a complaint. The distinction between these types of admissions is discussed in 2 JOHN W. STRONG, M CCORMICK ON EVIDENCE 137-38 (5th ed. 1999); *see also Ervin v. Vesnaver, 2000* WL 1211201, at *2 (Del. Super.).

[15] See 2 JOHN W. STRONG, M CCORMICK ON EVIDENCE 138 ("[A] judicial admission, unless allowed by the court to be withdrawn, is conclusive in the case, whereas an evidentiary admission is not conclusive but is subject to contradiction or explanation.*').

[16] The plaintiffs point out that the trial will be less than efficient if Applied Digital does not produce its best estimate of the Eamout Financials and specify exactly why it cannot reduce them to a final figure. I agree. That objective can be accomplished, however, through the discovery process. The plaintiffs shall promulgate interrogatories to Applied Digital that go to these questions, and Applied Digital shall answer them with specificity. This shall include the provision of Applied Digital's best estimate of Compec's earnings for the First Eamout Period, and of detailed explanations as to the reasons why it has, to date, refused to produce final Eamout Financials.

The foundation for Applied Digital's argument that Count II is arbitrable rests in the following provision of the merger agreement:

> (d) After receipt of the Eamout Financials, the Stockholders' Representative shall have 90 days to object, in writing, to the Eamout Financials or any of the Eamout Amounts as determined by ADS. Such writing shall provide reasonable detail as to the nature and amount contested.
>
> (i) If the Stockholders' Representative does not so object, the Eamout Financials and the Eamout Amounts, as the case may be, if any, as originally prepared and determined under this Section shall become final and binding on the parties.
>
> (ii) If the Stockholders' Representative does so object to the Eamout Financials or any portion thereof or either of the Eamout Amounts, the parties shall promptly attempt to resolve such objections. In the event the dispute is not resolved within 30 days of Stockholders' Representative's written objection, the Stockholders' Representative may designate a certified public accountant of its choice (the "Stockholders' Accountants") to prepare and/or review the Eamout Financials. ADS shall provide full access to Stockholders' Accountants and otherwise fully cooperate in connection with its review of the preparation of any such reports and the calculation of the Eamout Amount, and, assuming such access and cooperation, in no event shall the preparation and/or review of such reports by Stockholders' Accountants take more than 90 days from the designation by the Stockholders' Representative of the Stockholders' Accountants, in writing.
>
> In the event that, after the above process is complete, it is determined by the Stockholders' Accountants that the Eamout Financials or the calculation of the Eamout Amount, was correct as initially calculated, Stockholders shall also, in addition to paying for the costs of Stockholders' Accountants, be responsible for the incremental expense incurred, if any, of ADS's accountant; provided, however, if it is determined by the Stockholders Accountants that the Eamout Amount or the calculation of the Eamout Amount, was not

> correct as initially calculated, ADS shall pay all costs of Stockholders' Accountants.
>
> If the parties are still unable to arrive at an acceptable resolution, either party may submit the matter to binding arbitration and such arbitration shall be commenced and conducted in accordance with then applicable rules of commercial arbitration of the American Arbitration Association in an arbitration commenced and held before a single arbitrator. Judgment upon the award rendered by the arbitrator may be entered in any court having jurisdiction thereof. . . .[17]

According to Applied Digital, this provision bars the plaintiffs from litigating over the accuracy of the Eamout Financials because it remits any such dispute to binding arbitration. By its own admission, Applied Digital concedes that Count I of the complaint — which seeks a judicial order requiring Applied Digital to comply with its contractual obligations to produce the Eamout Financials — is not arbitrable and may be litigated. It therefore seeks an order dismissing Count II, or at the very least, staying it, until Count I is decided. If Count I is decided in plaintiffs' favor, Applied Digital says, the plaintiffs may then proceed to arbitration if they are unhappy with the Eamout Financials produced by Applied Digital in response to the court's order.

[17] Merger Agreement § 1.05(d).

In response to this motion, the plaintiffs contend that Applied Digital has waived its right to arbitration in two distinct ways. I agree with each of the plaintiffs' contentions for reasons I will now discuss.

As an initial matter, the plaintiffs argue that Applied Digital has expressly waived its right to arbitrate. When the federal action was dismissed on grounds unrelated to the merits of the plaintiffs' Eamout claims, the plaintiffs promptly filed this action and sought expedited treatment. An office conference on plaintiffs' motion to expedite was held on February 13, 2002. At that stage of the case, Applied Digital tried to defeat the plaintiffs' motion for expedition by arguing that the Earnout dispute was solely a question of monetary damages because both parties had waived their right to have the Eamout computed in accordance with the merger agreement.

As support for that contention, counsel for Applied Digital noted that the parties had been litigating in the federal courts for nearly a half year before this case was filed and no party invoked the arbitration clause during that process. Indeed, the plaintiffs in the prior federal action had pressed a claim for the First Eamout, and had sought to have the federal court expedite its treatment of that claim. In response, Applied Digital sought to have that claim dismissed, but not on the basis that the claim was arbitrable. To put a

point on this line of argument, Applied Digital's counsel said to this court, *"The defendants are not seeking arbitration . . . Applied Digital is not seeking arbitration.""*

Applied Digital now attempts to muddy its earlier, clear representation to the court that it was waiving arbitration of the Eamout claim. It bases this attempt on an ambiguous part of the February 13 transcript that can arguably be read as hedging Applied Digital's bets regarding arbitrability. But the better reading of that part of the transcript is that Applied Digital was arguing that the technical procedures for the creation of Eamout Financials were, as a practical matter, now inapplicable, and that the issue of what Eamout, if any, was due should be determined through an evidentiary hearing in a law court following discovery.[19] And Applied Digital fails to mention that later in the same hearing, counsel for Applied Digital repeated the statement that the Eamout calculation and arbitration procedures had "been ignored and waived by *each side* to this contract."[20]

In its reply brief, Applied Digital argues that some of these statements were made to this court by counsel for it in the federal case, and that this counsel never formally appeared in this action later on. As a matter of

---

[18] 2/13/02 Tr. at 35 (Pl. Opp. To Defs.' Mot. to Compel Arb. Ex. B) (emphasis added).

[19] ***See id.*** at 40-43.

[20] ***Id.*** at 48 (emphasis added).

litigation reality, however, Applied Digital's Delaware counsel knows that this court typically permits parties to have outside counsel appear at motions to expedite in advance of a formal *pro hac vice* motion. Because of the timing exigencies involved in these motions, this practice is in the interests of justice. It was Applied Digital's Delaware counsel — who remains counsel of record in this case — who asked for Mr. Vieth, the non-Delaware lawyer in question, to participate and help advocate Applied Digital's cause. For Applied Digital now to disavow his representations is a tad unseemly, particularly since it was happy to have Mr. Vieth make arguments on its behalf when those arguments could have advantaged it.[21] Moreover, Mr. Vieth was not unfamiliar with the matter; he had acted as counsel for Applied Digital in the recently terminated federal action. More fundamentally, Mr. Vieth's statements were never clearly disavowed by Applied Digital's Delaware counsel, as the transcript makes clear. Instead, Delaware counsel acquiesced in Mr. Vieth's statement near the end of the hearing that both sides had waived arbitration.

After that hearing, an expedited schedule was entered that provided for a trial in July 2002. On March *2, 2002,* the plaintiffs' filed their motion

---

[21] According to Applied Digital's Delaware counsel, "Mr. Vieth is participating on behalf of the defendants for purposes of this conference. . . " 2/1 3/02 Tr. at 15- 16.

for summary judgment on their Eamout claims. On March 15, 2002, Applied Digital filed a motion to dismiss this case on grounds other than arbitrability, but dropped a footnote raising for the first time its newly discovered desire to arbitrate. Ten days later, on March 25, 2002, Applied Digital finally filed this motion to compel arbitration of Count II.

The question thus posed is whether, on this record, I have clear and convincing evidence that Applied Digital has waived its right to arbitration by "actively participat[ing] in a lawsuit or tak[ing] other action inconsistent with the right to arbitration."[22] The answer is yes. In the prior federal court action, Applied Digital actively participated in litigation, seeking tactical advantage in obtaining dismissal of the plaintiffs' Eamout claims on other grounds without raising its demand for arbitration.[23] This action flows out of that prior federal case seamlessly, because Applied Digital knew that its strategy of seeking dismissal of the plaintiffs' federal claims might result in the procession of the plaintiffs' state law claims in this or another state court. Once this foreseeable litigation was filed, Applied Digital represented to me

[22] ***Falcon Steel Co. v. Weber Eng. Co.*** 5 17 A.2d 281,288 (Del. Ch. 1986).

[23] Applied Digital says it was not required to raise its arbitrability defense when it filed its motion to dismiss the plaintiffs' Eamout claim in the federal case. That may be true as a technical matter, but it is consistent with a waiver by Applied Digital that it sought dismissal in the federal court on the ground that there was no federal jurisdiction over the Eamout claim, but not on the logically related argument that the claim could only be heard by an arbitrator, and not any court at all.

that it had waived its own right to arbitrate and had no desire to seek arbitration. Thus, Applied Digital clearly took action inconsistent with its right to arbitrate.

Applied Digital's conduct is also prejudicial to the plaintiffs. By its own admission, Applied Digital's financial circumstances are precarious at best, and the company faces the potential delisting of its shares and the even worse spectre of possible insolvency. The timing by which the plaintiffs obtain any relief due to them might well affect whether that relief has any real value, and could influence the plaintiffs' standing in any bankruptcy proceeding involving Applied Digital. Knowing these facts, Applied Digital let the plaintiffs proceed full bore in the federal case without raising the arbitrability issue. It then allowed the plaintiffs to press forward in this case for over a month before retracting its prior waiver of arbitration. In these circumstances, the plaintiffs are sufficiently prejudiced to bar Applied Digital from now changing its mind.

Applied Digital's motion must also be denied for a second reason pressed by the plaintiffs. Assume that it is true, as the plaintiffs contend, that Applied Digital could have produced the Eamout Financials on or before September 30,200 1, or even at some reasonable date thereafter. If that is the case, Applied Digital's own breach of contract would have caused

the arbitration remedy in the contract to become commercially impractical. In that scenario, Applied Digital would have forced the plaintiffs to run an inequitable gauntlet not contemplated by the merger agreement. In order simply to extract the Eamout Financials, the plaintiffs would have to spend hundreds of thousands of dollars in legal fees, only to thereafter have to enter arbitration to actually obtain an Earnout award. By the time the plaintiffs ran this gauntlet, their purses would be much lighter and the benefits of any eventual remedy could be eliminated.[24]

Because the evidentiary record supports this scenario, I would therefore refuse to postpone a trial on Count II regardless of whether Applied Digital had not, by its express representations and prior litigation conduct, otherwise waived its right to arbitrate. Unlike the first waiver theory, however, this second theory has somewhat more limited implications. Under this second theory, a post-trial judicial determination of the actual Eamout amount would only be appropriate if the court found that Applied Digital had breached its contractual obligation to produce the Eamout Financials in a timely manner, causing sufficient delay to render the plaintiffs' right to a prompt Eamout determination in arbitration useless.

---

[24] *Cf.* Merger Agreement § 1 .5(d)(ii) (if Stockholders' Representatives object to Eamout Financials and the dispute is not resolved within 30 days of the Representatives' written objection, the Representatives may designate an accountant to review the Financials for errors – ***but that accountant only has 90 days to produce its calculations***).

Upon such a finding, it would then be appropriate for the court to immediately calculate the Eamout due to the plaintiffs.

By contrast, if the court found that Applied Digital was prevented from completing the Eamout Financials in a timely fashion by the Stockholders' Representatives and other Compec stockholders, the plaintiffs would fairly be remitted to their arbitration remedy once such Financials could be produced, since the delay in that remedy's availability would have resulted from conduct for which the plaintiffs bear responsibility. Even in that scenario, the parties would have to present the relevant evidence they possess regarding the Eamout Financials at trial in order to decide the predicate issue of whose conduct was responsible for the delay in their finalization, regardless of whether the court were eventually to reach the question of what Eamout payment was due.

But because Applied Digital has more generally waived its right to arbitration, the upcoming trial shall address the issue of what, if any, Eamout payment is due to the plaintiffs, and what, if any, ancillary injunctive[25] and other relief should accompany any such payment.

---

[25] For example, the plaintiffs have indicated that if an award is made in Applied Digital stock, they will seek a compulsory order requiring Applied Digital to take specific steps to register the stock rapidly.

V.

Applied Digital contends that this case must be dismissed because the plaintiffs have not joined all the previous stockholders of Compec who sold their shares in the merger. But the merger agreement itself dictates rejection of Applied Digital's motion.

As in many such agreements, the Applied Digital-Compec merger agreement specifically addresses the manner in which the multiple selling stockholders may, once the merger is contemplated, act to protect their collective interests. Such a provision is helpful to both the buyers and sellers in a merger, because it enables each side to resolve post-closing disputes efficiently. To accomplish such efficiency, the merger agreement empowers plaintiffs John Ballenger, Christopher Ballenger, and Henschel to act as "Stockholders' Representatives" for all the selling Compec stockholders. The authority of the Stockholders' Representatives is spelled out most directly in § 4.13(a) of the merger agreement, which states:

> 4.13. Stockholders' Renresentative
>
> (a) Upon the Effective Time and without further act of any Stockholder, John Ballenger, Chris Ballenger and Fred Henschel (collectively, the "Stockholders' Representative") shall be appointed as agent and attorney-in-fact for each Stockholder, for and on behalf of each such Stockholder, with full power of substitution, and with full power and authority to represent the Stockholders and their successors with respect to all matters arising under this Agreement, and all actions taken by the Stockholders' Representative hereunder

> shall be binding upon such Stockholders and their successors as if expressly ratified and confirmed in writing by each of them. Without limiting the generality of the foregoing, the Stockholders' Representative shall have full power and authority, on behalf of all the Stockholders and their successors, to interpret all the terms and provisions of this Agreement, to dispute or fail to dispute any "Claim of Damages" made by an Indemnified Party, to assert Claims of Damages against any Indemnifying Party, to negotiate and compromise any dispute which may arise under this Agreement, to sign any releases or other documents with respect to any such dispute, and to authorize delivery of any payments to be made with respect thereto. All determinations of the Stockholders' Representative shall be decided by a majority thereof in the event there is more than one Stockholders' Representative.[26]

In keeping with that provision, each of the selling Compec stockholders were apprised specifically of this provision of the merger agreement in the communication procuring their assent to the merger and acceptance of the merger agreement.[27]

---

[26] Merger Agreement $4.13(a).

[27] See Stockholder Authorization Form at 1:

> In connection with the Agreement and Plan of Merger, dated June 30, 2000 (the "Merger Agreement*') relating to the merger (the "Merger") of Computer Equity Corporation ("Compec") with and into Compec Acquisition Corp. ("Merger Sub"), a wholly-owned subsidiary of Applied Digital Solutions, Inc. ("ADS"), I hereby appoint each of you, John G. Ballenger, Christopher G. Ballenger and Frederick M. Henschel, as the Stockholders' Representative under the Merger Agreement, and, as such, I authorize you to act as agent and attorney-in-fact for me and on my behalf, with full power of substitution, and with full power and authority to represent me and my successors with respect to all matters arising under the Merger Agreement, subject to the terms of the Merger Agreement. I understand and acknowledge that all actions taken by you as the Stockholders' Representative thereunder shall be binding upon my successors and me as if expressly ratified and confirmed in writing by me and my successors, subject to the terms of the Merger Agreement and me.
>
> Pl. Br. in Opp. To Defs.' Mot. to Dismiss, Ex. A.

Not only that, the merger agreement also specifically addresses the role of the Stockholders' Representatives in challenging Applied Digital's compliance with the Eamout provisions of the merger agreement. Section 1.05(d) of the merger agreement makes Applied Digital's calculation of the Eamouts "final and binding" unless the Stockholders' Representatives object. The remainder of that section makes clear that it is the Stockholders' Representatives who have the authority to determine how far to press a dispute over an Eamout issue. This authority is in keeping with the Stockholders' Representatives' "full power and authority to represent the Stockholders and their successors with respect to all matters arising under [the merger] Agreement."[28]

Because of these provisions, Applied Digital has no reason to fear inconsistent judgments, because a judgment against the Stockholders' Representatives will bind all of the former Compec stockholders.*' Nor do the former Compec stockholders face prejudice, because they chose to give this authority to the Stockholders' Representatives, and will share on a *pro rata* basis in any recovery obtained in this case.

[28] Merger Agreement § 4.13.

[29] This comfort is increased by the fact that the litigation plaintiffs' collectively owned over three-quarters of Compec before the merger.

As part of its attempt to secure dismissal, Applied Digital seeks a declaration of some sort that would disqualify the three plaintiffs named in the agreement as the Stockholders' Representatives from acting as such. As noted previously, Applied Digital alleges that each of these plaintiffs — John Ballenger, Christopher Ballenger, and Henschel — engaged in improprieties while a member of Compec management. These supposed improprieties allegedly include diverting monies from the company to their own personal use. It is because of these improprieties, Allied Digital says, that it has been unable to calculate the Eamout Financials, and why it believes that no Eamout will likely be due once the accounting is completed.

Suffice it to say that this accusations of wrongdoings are hotly disputed, and cannot form the basis for a dismissal order in advance of an evidentiary hearing. And in any event, the Stockholders' Representatives would seem to have an interest (aligned with that of the other former Compec stockholders) to disprove these allegations. That is, the Stockholders' Representatives and the former Compec stockholders are all advantaged by a ruling that generates the highest possible Eamout from Applied Digital. Therefore, it is difficult to see the conflict of interest in representation.

As important, I am reluctant to disregard the clear contractual authority of the Stockholders' Representatives at the behest of a party, Allied Digital, whose aims are clearly adverse to those of the former Compec stockholders. Allied Digital's tactical interest in avoiding a determination of its Earnout liability (if any) makes it a suspect party to vindicate the interests of the former Compec stockholders. If those stockholders believe that the Stockholders' Representatives have breached their duty of loyalty to them, they (and not Applied Digital) may seek relief against the Stockholders' Representatives, as § 4.13(c) of the merger agreement makes clear.

VI.

Applied Digital also seeks to dismiss Count III of the plaintiffs' complaint. That count seeks relief because Applied Digital allegedly breached its obligations under the registration rights agreement to use its best efforts to register promptly the shares paid to Compec stockholders in the merger. The court also alleges that Applied Digital breached its duty to piggy-back the Compec stockholders shares on any earlier registration.[30] In that regard, the plaintiffs contend that Applied Digital registered other shares

[30] These breaches are pled primarily as involving conduct in violation of the registration rights agreement; however, they are also pled as violations of the merger agreement's implied coercement of good faith and fair dealing.

in April 200 1, some months before the Compec stockholders' shares were registered.

Applied Digital argues that the damages the plaintiffs seek in Count III are barred by § 1.05(e) of the merger agreement, which provides:

> Price Protection. ADS agrees that with regard to any shares of ADS Common Stock issued pursuant to this Agreement as Merger Consideration, if, on the effective date of the Registration Statement registering any such shares of ADS Common Stock (the "Effective Date"), the closing price of ADS Common Stock, as published in *The Wall Street Journal,* Eastern Edition (the "Effective Date Price"), is less than the applicable Valuation Price, ADS shall convey to the Stockholders a number of additional shares of ADS Common Stock equal to (A) the number of shares equal to either (i) the Closing Stock Payment, (ii) the First Eamout Amount or (iii) the Second Eamout Amount, as the case may be, in each case multiplied by a fraction, the numerator of which is the applicable Valuation price and denominator of which is the applicable Effective Date Price, minus (B) the number of shares issued at either (i) the Closing, (ii) the First Eamout Date or (iii) the Second Eamout Date, as the case may be. Shares of ADS Common Stock issued pursuant to this section shall be issued on the Effective Date with the registration rights set forth in the Registration Rights Agreement."

In essence, this provision protects the Compec stockholders against a price decline that occurs between the date they received their Applied Digital shares and the time that Applied Digital registered those shares.

According to Applied Digital, § 1.05(e) is a liquidated damages provision that cabins the relief that the Compec stockholders can receive for

---

[31] Merger Agreement § 1.05(e).

any delay in registration. Applied Digital did not register the shares it paid to the Compec stockholders until the summer of the year 200 1, thus triggering the price protection provision in § 1.05(e). Without dispute from the plaintiffs, Applied Digital contends that it complied with § 1.05(e) by increasing the number of shares the Compec stockholders received in accordance with that provision.

The area of contention centers on whether Applied Digital's compliance with § 1.05(e) constitutes a complete remedy for the breaches of contract alleged in Count III of the plaintiffs' complaint. Applied Digital claims that it is indisputably clear that all it had to do to remedy either of the registration-related breaches pled in Count III was to comply with § 1.05(e). That is, Applied Digital was free to breach its "best efforts" and "piggyback" duties so long as it was prepared to pay the price set forth in § 1.05(e).

As the basis for a motion to dismiss, Applied Digital's argument is unavailing. The price protection in § 1.05(e) is not tied in any manner to a "breach" of the registration rights or merger agreement. It simply provides price protection in the event of a delay in registration, regardless of Applied Digital's compliance with its contractual best efforts and piggyback duties. Although it is not determinative in itself that the merger agreement does not label § 1.05(e) as a liquidated damages provision setting forth the sole

remedy for any breach of Applied Digital's duties under the registration rights and merger agreements, if Applied Digital is to prevail on this motion this must have been the unambiguous intention of the contracting parties.[32] But no clear understanding of this kind emerges from the relevant contractual provisions.

To the contrary, the most logical reading of the contracts is that § 1.05(e) existed to deal with the reality that there would likely be delay in registration regardless of whether Applied Digital carried out its contractual registration responsibilities. Put differently, the § 1.05(e) price protection was available to the Compec stockholders even if Applied Digital did not breach the separate registration rights agreement, or the merger agreement itself. Likewise, if the price of Applied Digital shares increased during the period of delay, § 1.05(e) would not entitle the Compec stockholders to additional shares even if Applied Digital had breached its registration duties.

Absent contractual text revealing an intent for § 1.05(e) to cover registration breaches, it is therefore more sensible to read the merger agreement as permitting the Compec stockholders to seek additional

---

[32] *Polish Am. Mach. Corp.* v. *R. & D. Corp., 760* F.2d 507, 512 (3d. Cir. 1985) (for liquidated damages analysis to be appropriate, the agreement "must reveal some explicit evidence of the parties' intent to provide for liquidated damages . . . . "); *ADP-Financial Computer Sews., Inc. v. First Nat 'l Bank of Cobb County, 703* F.2d 1261, 1264 (11" Cir. 1983) ("While the words 'liquidated damages' are not specifically required, some manifestation of the parties' intent to agree to liquidated damages is.").

damages for such affirmative breaches.[33] As the plaintiffs point out, the price protection of § 1.05(e) does not necessarily remedy any injury the Compec stockholders suffered from illiquidity resulting from a registration-related breach by Applied Digital. Nor am I prepared to conclude, without an evidentiary hearing shedding light on the matter, that the plaintiffs' related argument is without force; to wit, that the prior registration of other Applied Digital shares in advance of those of the Compec stockholders caused an injurious dilutive impact that is compensable in damages. Taken as a whole, the plaintiffs' argument is that the alleged breaches of the registration rights agreement caused the Compec stockholders to receive large blocks of stock at a time when the sale of such stock would result in an immediate sharp drop in the market price at which they could sell. In support of that contention, the plaintiffs allege that they received shares with putative value of over $15,000,000 but were able to sell those shares for less than 60% of that value.[34] Had they received registration of the shares

---

[33] In prior cases inferring that a clause not labeled as a liquidated damages provision had the effect of barring additional damages, there has usually been contractual language supporting that conclusion. For example, In *Donegal Mut. Ins. Co. v. Tri-Plex Security Alarm Sys.*, 622 A.2d 1086 (Del. Super. 1992), the relevant contractual provision stated an amount of money that limited the amount of relief the party purchasing an alarm system could receive for any breach of the contract by the security firm to a sum certain, which would be the "complete limit" of the security firm's liability. Id. at 1087. Applied Digital has failed to cite to any language of this kind in the merger agreement.

[34] Compl. ¶ 33.

earlier, plaintiffs claim, the Compec stockholders could have liquidated their positions at a higher, overall price level. While the plaintiffs will have to prove these theories to recover damages, Applied Digital has not convinced me that § 1.05(e) of the merger agreement bars their right to recover such damages if they proximately result from a breach of Applied Digital's registration duties. Thus, Applied Digital's motion to dismiss in this regard is denied.

VII.

For the foregoing reasons, the plaintiffs' motion for partial summary judgment is denied; Applied Digital's motion to compel arbitration and to stay proceedings related to Count II is denied; Applied Digital's motion to dismiss or, in the alternative, for summary judgment for failure to join indispensable parties is denied; and Applied Digital's motion to dismiss Count III of the complaint is denied.

IT IS SO ORDERED.