

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

MARTHA S. SUTHERLAND,)
as Trustee of the Martha S. Sutherland)
Revocable Trust dated August 18,)
1976,)
)
Plaintiff,)
)
v.) C.A. No. 671-N
)
DARDANELLE TIMBER CO.,)
a Delaware corporation,)
)
Defendant.)

MEMORANDUM OPINION AND ORDER

Submitted: March 20, 2006

Decided: May 16, 2006

J. Travis Laster, Esquire, ABRAMS & LASTER, Wilmington, Delaware; Bonita L. Stone, Esquire, Stewart T. Kusper, Esquire, KATTEN MUCHIN ROSENMAN LLP, Chicago, Illinois, *Attorneys for the Plaintiff.*

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LAMB, Vice Chancellor.

This case concerns a books and records action brought by a 25% stockholder of a closely held corporation and its subsidiary, which the defendants resist on the basis of the plaintiff's purported failure to satisfy the requirements of 8 *Del. C.* § 220. This case was tried before the Master in Chancery on May 26, 2005, who granted relief to the plaintiff on the majority of her requests after post-trial argument. Having considered the exceptions taken by both parties to the Master's final report, and having conducted its review of the record de novo, the court concurs with many of the Master's conclusions, and grants the relief described in this opinion.

I.

The facts underlying this action are set out in the Master's draft report of August 31, 2005, and in his final report of November 18, 2005. Having conducted the de novo review of the record required by our law, the court here provides a brief summary of those facts for the purposes of this opinion.

A. The Parties

Dardanelle Timber Co. is a family owned and operated Delaware corporation, which, in part through its wholly owned subsidiary Southwest, Inc., is in the business of operating retail lumber yards and stores. Both companies were founded by Dwight D. Sutherland, Sr. ("Dwight Sr."), who served as president until his death in October 2003.

Approximately three decades ago, Dwight Sr. gave 25% of Dardanelle's common stock to each of his children, referred to in this opinion by their first names for ease of identification: Martha, Dwight Jr., Perry, and Todd. At the time, the preferred shares of Dardanelle were owned jointly by Dwight Sr. and his wife, Norma Sutherland. After Dwight Sr.'s death, the preferred shares were transferred to a trust for Norma's benefit.

B. The Role Of The Four Sutherland Children In The Management Of Dardanelle And Southwest

The votes of the preferred shares set aside for Norma's benefit are controlled by Perry, as trustee. This authority means that, although he personally controls only 25% of the Dardanelle and Southwest common stock, Perry can control both corporations with the cooperation of one of the Dwight Sr. children, with whom he would control 50% of the common stock, and also the voting preferred. The facts adduced at trial show clearly that Perry controls both companies exactly in this way with the help of his twin brother, Todd. Specifically, Perry and Todd constitute a majority of Southwest's three-member board, a majority of Dardanelle's board, and serve as the principal officers of both companies.

Despite her 25% stake in the two companies, Martha was never substantively involved with the management of the family business. Among the various reasons for that detachment, it suffices to say that Martha's demanding

career as an active CIA agent precluded her from becoming intimately involved in the management of a private corporation. In sum, her participation in company management until October 2003 consisted of signing unanimous consents on behalf of her shares whenever they were presented, except for one request for information from Perry and Todd, which went unanswered, in 1997 or 1998.¹

Dwight Jr., a lawyer, has been somewhat more active than his sister in exercising his rights as a major Dardanelle stockholder. The trial evidence shows clearly that Dwight Jr. had certain disagreements with Perry's and Todd's stewardship of the company well before Dwight Sr.'s death.² In a letter to Perry dated November 28, 2001, for example, Dwight Jr. requested certain of Dardanelle's books and records, explaining that "I can hardly agree with your contention that your compensation is well justified until I see what you're paid (directly or indirectly) and what the actual profitability of the company is."³ By June 2002, the tensions between Dwight Jr. and Perry had risen to the point that Dwight Jr. felt compelled to oppose the institution of Norma's voting trust

¹ Trial Tr. 282:1-8.

² In addition to the letter discussed below, Dwight Jr. testified at trial that although he had never refused to sign consents during his tenure as a director of Dardanelle, he complained to his father, brother, mother, and to Martha about the way that Perry was running the company allegedly for his own benefit. Trial Tr. 249:10-21.

³ JX 44. The defendants, in arguing that Martha's claim should be denied because she supposedly waived any objections to Perry's and Todd's rule by failing to act before 2004, place much emphasis on the fact that in the same letter, Dwight Jr. praised Perry for his leadership of the two companies. He expressed, for example, "admiration for the way [Perry] steered [Southwest] out of the abyss when things got bad in the oil patch in the 80s." *Id.*

agreement, with Perry as trustee, believing that the agreement would, unjustly, give Perry control over the company. Rather than challenge the decision at the Dardanelle board meeting called to authorize the transfer of the preferred shares into the trust, however, Dwight Jr. decided to resign from the board of Dardanelle in protest.⁴ As he explained at trial, he believed that resigning was preferable to antagonizing his father, who was in failing health, for the sake of an unwinnable vote.⁵

C. The Death Of Dwight Sr.

Dwight Sr. died in October 2003. His will was read to the Sutherland family on November 5, 2003. Although the facts as to this point are unclear, the evidence adduced at trial suggests that Martha and Dwight Jr. were, to some extent, unhappy with the disposition of their father's estate.⁶ The evidence further shows that both Martha and Dwight Jr. suggested to their mother that she retain independent legal advice, at least in part to assist her with estate planning.⁷ Clearly, these efforts roused tensions within the Sutherland family,⁸ and form part of the basis for the

⁴ Trial Tr. 262.

⁵ *Id.* at 263:1-8.

⁶ *Id.* at 236:1-21.

⁷ *Id.* at 243-44.

⁸ In a letter from Dwight Jr. to Perry dated March 9, 2004, Dwight Jr. notes his desire that "any decision that [Norma] makes in regard to her own estate plan should be an informed decision, based on disinterested professional advice," but also observes that Perry's angry response to Dwight Jr.'s proposal "reveals an extreme personal hostility to Martha and I and attributes to us all sorts of mercenary and malign motives that simply don't exist." JX 27.

defendants' contention that the instant case is motivated by the plaintiff's disappointment at Dwight Sr.'s will.

D. Martha Is Secretly Removed From Her Position As A Director Of Southwest

Perry was always meant to succeed Dwight Sr. as the operational head of Dardanelle and Southwest. Shortly after the patriarch's death, therefore, Sutherland employees sent Martha unexecuted consents to authorize the appointment of Perry as president of Southwest. Although these were the same kinds of consents Martha had routinely signed in the past, on this occasion she took no further action. On January 2, 2004, Sutherland employees sent the requests again, along with consents for another Sutherland business, Cherokee Advertising Co.⁹

By now, however, Martha was more determined to be actively involved in the family business. She had spoken to Dwight Jr. about the way that Perry and Todd were running the business, and believed that there was evidence that her brothers were committing some kind of wrongdoing. On that basis, Martha affirmatively refused to sign the consents without further information.¹⁰ On February 2, 2004, Perry responded to Martha's refusal by directing Dave Dotson of Southwest to begin preparing documents to secretly remove Martha from the board

⁹ JX 48.

¹⁰ Trial Tr. 44.

of the company. When Martha continued to refuse to cooperate, and left Perry a voice message briefly discussing her concerns,¹¹ Perry executed his plan to remove Martha by secretly holding the annual Southwest stockholders' meeting on February 20, 2004,¹² where he replaced Martha as a director with Mark Sutherland, his cousin. At the same meeting, Perry had himself appointed president of Southwest, caused Southwest to approve an employment agreement governing his service in that position, and caused Todd to be appointed vice president and secretary. Contemporaneously, Dardanelle's board met and approved an equivalent employment agreement for Perry as its president and CEO.¹³

E. Perry's And Todd's Employment Agreements

The employment agreements provide, in part, the source of Martha's suspicions of wrongdoing, and therefore require some further description. At the threshold, all three agreements at issue claim that Perry and Todd had been performing services for Dardanelle and Southwest pursuant to pre-existing oral agreements with Dwight Sr. They purport, therefore, merely "to memorialize the terms of such employment relationship."¹⁴

¹¹ Trial Tr. 45:5-14; 46:1-12.

¹² *See, e.g.*, Trial Tr. 313:24-314:2.

¹³ JX 8-9.

¹⁴ JX 6; JX 8.

The agreements provide Perry and Todd with both cash payments and various other benefits in return for their services. As to cash, Perry is paid a combined salary of \$200,000 per annum for his services as president and treasurer of both Dardanelle and Southwest. Todd, who is vice president and secretary of Southwest only, is entitled by his agreement to a salary of \$14,760. The agreements also provide that Perry and Todd retain the right to compete against the Sutherland companies without limitation, and if they are terminated “for any reason” will continue to receive their salaries for a period of two years.

The agreements identify three additional benefits available to both Perry and Todd—unlimited personal access to an airplane 50% owned by Southwest, whenever the airplane is not otherwise occupied,¹⁵ access to the Maysville training center,¹⁶ and personal accounting and tax advice provided by Cimarron Service, a financial services subsidiary apparently shared by the Sutherland companies.¹⁷ The agreements differ, however, as to the two brothers’ responsibilities to reimburse Dardanelle and Southwest for their use of these benefits. Under his agreements,

¹⁵ Neither the plaintiff nor Dwight Jr. were able, at trial, to describe the extent of Perry’s or Todd’s personal use of the aircraft. *See, e.g.* Trial Tr. 266:1-10.

¹⁶ According to the trial testimony, Maysville, which is also known as the Sutherland Training Center, was started in the 1920s as a family farm, and in the 1950s and 1960s became a training facility for Sutherland Lumber employees. Clearly, however, Maysville is now at least in part a “personal vacation spot for the family members,” and for that reason is included in the benefits provided to Todd and Perry. *Id.* at 65-66.

¹⁷ *Id.* at 78:1-8.

Perry need not reimburse either Dardanelle or Southwest for any of these three benefits. Rather, the agreement provides that these costs will be treated as compensation, and added to Perry's W-2 in the year in which costs are incurred. Todd, in contrast, has the same rights as Perry as to the Maysville training center and as to financial services, but must reimburse the company for any personal usage of the airplane at the prevailing rate charged by an owner for third party use.

F. Martha Informally Requests Information

The tension between the two Sutherland camps reached a new peak on March 11, 2004, during a meeting of the directors of the Dwight D. Sutherland Foundation, a charitable institution created by Dwight Sr.¹⁸ At that meeting, Dwight Jr. raised his concern that the Foundation's purchase of certificates of deposit at a small bank owned by Todd could cause the IRS to classify the Foundation and the bank as affiliates, and thus could lead to certain tax consequences adverse to the Foundation or its directors.¹⁹ Perry believed that Dwight Jr.'s concerns were being raised in an inappropriate venue, and, as he testified at trial, he lost his temper.²⁰ During the resulting confrontation, Perry used his voting power over the Foundation to close the issue, and strongly intimated to

¹⁸ The directors of the Foundation, after Dwight Sr.'s death, included Norma, Dwight Jr., Perry, Todd, and Mark Sutherland. *Id.* at 47.

¹⁹ *Id.* at 46-49; 315-318.

²⁰ *Id.* at 317:16.

Dwight Jr. that he would react similarly whenever Dwight Jr. tried to raise objections to Perry's stewardship of the Sutherland companies.²¹

Dwight Jr. told Martha about the course of the Foundation meeting during the evening of March 11, 2004.²² Consequently, on March 13, 2004, Martha telephoned Dotson to request certain records and information as to the Sutherland companies from 1990 to the present, including corporate records, by-laws, articles of incorporation, financial results, and tax returns.²³ Martha called again on March 15, at which time she spoke personally with Dotson and discussed the information and records she wanted.²⁴ Because Dotson said her requests for company information must be in writing,²⁵ Martha followed up the March 15 call with an email on the same day.²⁶ Dotson passed the requests to Perry, who responded by letter on April 13, 2004. In that communication, Perry provided some, but not all, of the information Martha requested in her call and email.²⁷ For example, as is clear from the evidence reviewed by the Master, Perry provided financial information only for the latest fiscal year of the corporation, and omitted the explanatory notes that necessarily accompany financial disclosures. Nonetheless,

²¹ *Id.* at 318:10-16.

²² *Id.* at 46-48.

²³ JX 9.

²⁴ *Id.*

²⁵ Trial Tr. 52:20-24.

²⁶ JX 9; Trial Tr. 53:20-22. Dotson apparently received this email only on April 4, 2004. JX 12.

²⁷ JX 16.

Perry's letter assured his sister that "the Company is being operated in the same manner as it has been for the past twenty-three years,"²⁸ and that his incomplete production constituted a "good faith effort to respond to [her] request."²⁹ After reviewing the limited documents she received, Martha became aware for the first time that she was no longer a Southwest director, and that Perry and Todd had approved new employment agreements for their own benefit at the February 20, 2004 meetings.³⁰

The employment agreements became more significant to Martha because of their apparent inconsistency with a letter she received from Dotson on March 17, 2004. In part, that letter describes changes in the billing treatment of tax and accounting services provided by Cimarron to various "Dwight D. Sutherland Family entities." According to Dotson, those entities would now be billed "actual time/charges each fiscal quarter for work done, rather than a fixed fee."³¹ In addition, however, the letter confirmed that Dardanelle and Southwest would continue to "absorb actual time charges for all *other* DDS Family individuals, trusts, partnerships, LLC's, and corporations as it does currently, billing each a fixed fee quarterly."³² But Martha knew, as a result of Perry's document

²⁸ *Id.*

²⁹ *Id.*

³⁰ Trial Tr. 62:13:18.

³¹ JX 10.

³² *Id.*

production, that Perry and Todd had been promised that their access to accounting services through Cimarron would be subject only to reporting as income on their W-2s. Martha also knew that she had always been billed directly by Cimarron, and not by Dardanelle.³³ In Martha's view, therefore, the changes cited in the March 17, 2004 letter were inconsistent with what she had personally experienced, and with what she found out through Perry's initial production of documents.³⁴ On that basis, Martha suspected that Perry's and Todd's formal employment agreements did not encompass the entirety of the compensation they received from the Sutherland companies.

G. Martha's Formal Demand For Books And Records

Unsatisfied by Perry's response to her informal request, and with her suspicions raised further by what she did find out from the documents produced, Martha hired counsel and made a formal written demand on July 13, 2004 under 8 *Del. C.* § 220 for 19 categories of books and records of both Dardanelle and Southwest. Martha's letter stated that her purpose in making demand was to "investigate the propriety and lawfulness of certain actions by [the defendants], and the bases for possible shareholder derivative or other actions relating thereto as

³³ Trial Tr. 28-29.

³⁴ Pl.'s Opening Br. 18. Martha also had suspicions regarding accounting work, done by Cimarron and paid for by Dardanelle, for Choctaw Racing Stables, a horse racing venture including a number of horses that were owned, maintained, trained, and raced by Perry and Dwight Sr.

may be necessary, appropriate and warranted based in whole or in part upon facts revealed in and through the documents sought to be inspected.”³⁵

Dardanelle responded to the July 2004 demand on July 21, 2004, refusing to permit inspection, and asserting that the July 2004 demand was insufficient under Delaware law because it did not make the evidentiary showing required to prevail at trial. As the defendants argued in that communication, “Ms. Sutherland’s letter is . . . an improper request under [8 *Del. C.* § 220] [because] . . . the history of this shareholder’s relationship and dealing with the directors and officers of Dardanelle Timber Co., Inc. makes it rather clear that the demand for inspection is for personal and vexatious purposes with no or very little relation to the interest of Ms. Sutherland as a shareholder.”³⁶ Martha’s counsel sent a further reply in August 2004 reiterating the plaintiff’s position,³⁷ to which the defendants replied negatively on August 16, 2004.³⁸ Finally, Martha filed the instant action on August 31, 2004. Shortly thereafter, Martha received a letter from Perry and Dardanelle, dated September 3, 2004, stating that Dardanelle’s certificate of incorporation had been amended without prior notice to eliminate Martha’s rights to cumulative voting.³⁹

³⁵ JX 1.

³⁶ JX 2.

³⁷ JX 3.

³⁸ JX 4.

³⁹ JX 17.

II.

The Master heard post-trial argument in this action on August 31, 2005, and orally rendered his draft report the same day. In that report, the Master found that investigation of whether there was self-dealing on the part of Dardanelle management was a proper purpose under the law. As the Master stated:

And so I think that Martha, as a stockholder of this closely held corporation, which had few or no public records, no market, wanted to investigate whether there was self-dealing on the part of her brothers Todd, and particularly Perry. Now, that's a proper purpose under Section 220.⁴⁰

Second, the Master found that this purpose was the plaintiff's primary purpose in seeking to inspect the corporate books and records at issue, rejecting the defendants' argument that Martha's desire to investigate the books and records was primarily motivated by any ulterior motives. As the Master explained:

Now, are there other motives involved? I'm sure there are. This is a family that has a long history. We're dealing with family issues here, not simply monetary issues. [Martha] may very well have been disappointed by the way her father disposed of his property in his will. But I find that her primary purpose was a proper one: investigating whether there's self-dealing on the part of the corporate management of Sutherland and Southwest.⁴¹

Finally, the Master found that the defendants' actions raised a credible basis to suspect wrongdoing at Southwest and Dardanelle, for the following reasons:

⁴⁰ Tr. of Post-Trial Argument 79:11-17.

⁴¹ *Id.* at 79-80.

[Martha was] removed from the board of Southwest, leaving Perry and her brother Todd in voting control of both Southwest and Dardanelle; and that exercising that control as fiduciaries, Perry and Todd have employed themselves as executives and, in further exercise of that control, they have awarded themselves salaries for that employment and benefits. The fact that the base compensation doesn't appear large, out of line, the fact that the amount of benefits personally received by Perry or Todd were not well demonstrated at trial, to my mind, is not relevant. The fact that a corporate charter provision may ratify the self-dealing and the fact that the founder of the company, Dwight Sr., condoned and participated in similar self-dealing, or wished it to continue, as has been suggested to me, is not dispositive. The fact that Martha herself may have turned a blind eye in the past and perhaps breached fiduciary duties when she was a fiduciary for Southwest, once again, it's not dispositive here; nor is the fact that at some future date the corporate management may be able to show safe harbor for the self-dealing because there was an independent director involved. All these issues may be highly relevant in a trial on the merits, should one ever come; but for my purposes here, I find that there's been a credible basis demonstrated to believe that, in using their powers as fiduciaries, Perry and Todd set benefits and perquisites for themselves as employees, and that's self-dealing.⁴²

Therefore, the Master held, "once this order becomes final, the documents that have been requested that are relevant to showing what benefits Perry and Todd have become entitled to and have taken should be produced."⁴³

The parties were unable to agree on a form of final order. The Master therefore issued a letter opinion in response to both parties' request for clarification of the bench draft report. In that letter, the Master reiterated his findings of facts,

⁴² *Id.* at 80-81.

⁴³ *Id.* at 81:18-23.

and then ruled that the plaintiff was due access to documents “relating to the enjoyment of salary and benefits by Perry and Todd for the period commencing one full fiscal year before the death of Mr. Sutherland Sr.”⁴⁴ The Master, further, specifically defined the inspection to track “the language of the plaintiff’s initial demand letter, narrowed to the documents that [the Master] found sufficient to fulfill the purpose demonstrated at trial.”⁴⁵ In short, this narrowing effectively eliminates information relating to the activities of Cimarron from the demand, limits the reach of paragraphs 1-3, omits the contents of paragraph 19 of the July demand letter, and otherwise summarizes the categories of information originally demanded by Martha.

⁴⁴ *Sutherland v. Dardanelle Timber Co.*, 2005 Del. Ch. LEXIS 181, *4-5 (Del. Ch. Nov. 18, 2005).

⁴⁵ These documents were described as follows: “all documents which relate to the salary and benefits and perquisite received by Perry or Todd, at the expense of Dardanelle or Southwest, whether pursuant to a written contract of employment, an oral contract of employment, or otherwise, and to have the financial statements of the corporations to put this compensation in context. This includes all documents relating to the use by Perry or Todd or their immediate families, for personal purposes, of any aircraft owned or leased by Southwest or Dardanelle including documents relating to the tax ramifications of such use to the corporations involved; documents relating to the expense accounts and to expense reimbursement records for Dardanelle or Southwest concerning Perry or Todd; documents relating to expenditures of money or services by Southwest or Dardanelle pertaining to Choctaw Racing Stables; documents relating to any loans from Dardanelle or Southwest to Perry, Todd, their immediate family members, or entities in which they have an ownership interest; documents relating to expenditures by Dardanelle or Southwest for the use of the Maysville Training Center on behalf of Perry, Todd or their immediate families; copies of financial statements for Dardanelle and Southwest for the period in question; documents relating to all remuneration in cash or kind paid by Dardanelle or Southwest to Perry or Todd; documents relating to the sale of assets by Dardanelle or Southwest to Perry or Todd, as well as documents relating to any transactions between those companies and Perry or Todd.” *Id.* at *5.

III.

The defendants raise three independent exceptions to the Master's report. First, they argue that the Master should have dismissed the plaintiff's action on the motion to dismiss, and that he erroneously allowed a facially conclusory complaint to survive that stage of litigation on the basis of "generic representations" made by Martha's counsel at oral argument. Second, the defendants argue that the Master erred in finding that Martha's stated purpose to investigate wrongdoing was her actual, primary, purpose. Rather, the defendants argue, the facts adduced at trial evidence definitively that Martha acted under one of several potential ulterior primary motives. Third, the defendants argue that the Master erred in finding that the plaintiff had satisfied her burden of showing sufficient evidence of wrongdoing to suggest a proper purpose of investigating waste and mismanagement. Finally, and in addition, the defendants argue that if any relief is granted to the plaintiff, it should include a much smaller set of documents than that recommended by the Master, and should only commence at the time of Dwight Sr.'s death, when Perry and Todd definitively took control of the defendant corporations.

The plaintiff raises two exceptions to the Master's report. First, the plaintiff argues that the Master improperly limited her inspection to books and records for one full fiscal year prior to the death of Dwight Sr. Rather, she argues, the Master should have ordered much broader inspection, because Perry's and Todd's alleged

wrongdoing dates back even beyond the seven year period for which books and records were sought in the July 2004 demand. Second, the plaintiff argues that the Master improperly limited the subject matter of her demand to the extent he narrowed the categories set forth in the July 2004 demand.

IV.

The Supreme Court has held that the standard of review for a Master's findings, both factual and legal, is *de novo*.⁴⁶ In their papers, and at oral argument, the defendants argue that part of the court's responsibility in considering the trial record *de novo* is to hold an evidentiary hearing to examine the credibility of Martha's testimony. As the Supreme Court has explained, however, such a hearing is only inevitable "where exceptions raise a *bona fide* issue as to dispositive credibility determinations."⁴⁷ Otherwise, this court may conduct its *de novo* review based on the record alone.⁴⁸

Contrary to the defendants' argument that the Master's determination of Martha's actual purpose inherently relies on her state of mind, the court determines that neither parties' exceptions in this case raise such an issue of credibility. Rather, the record seems to clearly indicate that the Master drew his conclusions based on the uncontraverted facts before him. Further, the court's review of the

⁴⁶ *DiGiacobbe v. Sestak*, 743 A.2d 180, 184 (Del. 1999).

⁴⁷ *Id.*

⁴⁸ *Id.*

record demonstrates conclusively that the defendants have raised no legitimate issue of credibility that could have an effect on the disposition of this case. For that reason alone, the court refuses the defendants' request for an additional evidentiary hearing. Further, however, the court notes that deciding in favor of the defendants in this case, where the record is so full and the case has been so vigorously litigated, could have the dramatic effect of requiring an evidentiary hearing in any books and records case that is referred to a master where the defendant raises a factually specific affirmative defense. Because factual defenses such as improper purpose are a routine part of Section 220 litigation, therefore, virtually all books and records cases referred to a master would then be subject to substantial further proceedings before this court. The Master's lack of constitutional authority to render binding decisions does not require such a byzantine and costly procedure as a general matter, and the court sees no reason to adopt it in this case.

V.

A. Martha's Right To Inspect The Books And Records Of Dardanelle And Southwest

The defendants have two central arguments against Martha's entitlement to the books and records of Dardanelle and Southwest. Most important, the defendants believe that Martha has failed to present sufficient evidence of

wrongdoing to justify the relief she was afforded by the Master. Second, the defendants argue that the Master erred in failing to recognize that Martha's actual purpose in pursuing this case is not, as she claims, to investigate the Sutherland companies for evidence of management wrongdoing, but rather to pursue a personal agenda against her brothers, Perry and Todd. This actual purpose, the defendants claim, is clearly improper.

Delaware law provides a statutory right for a stockholder to inspect the books and records of a corporation under 8 *Del. C.* § 220, provided that the form and manner requirements for making a demand are met, and the inspection is for a proper purpose.⁴⁹ The statute defines "proper purpose" as any purpose "reasonably related to such person's interest as a stockholder."⁵⁰ The investigation of possible breaches of fiduciary duty is such a proper purpose. But, a plaintiff seeking inspection for that purpose must demonstrate some credible evidence of possible mismanagement sufficient to warrant further investigation.⁵¹

This standard has sometimes been rendered as a requirement that the plaintiff demonstrate "a credible basis to find probable wrongdoing."⁵² But that

⁴⁹ *Grimes v. DSC Commc'ns*, 724 A.2d 561 (Del. Ch. 1998); DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY § 8.6(g) (2005).

⁵⁰ 8 *Del. C.* § 220(b).

⁵¹ *Security First v. U.S. Die Casting & Dev. Co.*, 687 A.2d 563 (Del. 1997).

⁵² *Id.* at 570; *Thomas & Betts Corp. v. Leviton Mfg. Co.*, 681 A.2d 1026, 1031 (Del. 1996).

somewhat inartful formulation should not be understood by litigants to require a showing akin to that required to withstand a motion to dismiss under Court of Chancery Rule 12(b)(6). Rather, as the Supreme Court has made clear, all that must be demonstrated is “some credible basis from which the court can infer that waste or mismanagement may have occurred.”⁵³ In other words, the pleading requirement set forth in our cases exists to ensure that a Section 220 plaintiff does not initiate a books and records action merely to satisfy its own curiosity or suspicion.⁵⁴ Rather, a plaintiff must have some reason to believe that wrongdoing has taken place.

A defendant facing a Section 220 action may resist that demand by showing that the plaintiff’s purpose, although a valid one, is not the actual purpose.⁵⁵ In other words, the defendant may try to show that the plaintiff has pursued its claim under false pretenses. This defense is both fact based and hard to establish, but our courts have evidenced a somewhat greater willingness to scrutinize the credibility of the stated purpose when the stockholder’s demand is for books and records rather than merely for a stockholder’s list. As this court has noted, the corporation “[un]questionably is entitled to challenge the plaintiff’s stated purpose and to show as a factual matter, the plaintiff’s true purpose is other than what is

⁵³ *Thomas & Betts Corp.*, 681 A.2d at 1031.

⁵⁴ *Security First*, 687 A.2d at 563.

⁵⁵ *WOLFE & PITTINGER*, *supra* note 49, at § 8.6(g).

stated in the demand.”⁵⁶ Nonetheless, such defenses must first overcome the extensive decisional law to the effect that secondary motivations for seeking inspection, even if improper, will not be examined by the court once a proper purpose has been established.⁵⁷

At the threshold, therefore, the court must consider whether the plaintiff has proven a credible basis to believe that wrongdoing was afoot at Dardanelle.⁵⁸ Having considered the evidence in full, the court believes that Martha has amply satisfied that burden. First, the court agrees with the Master that Martha’s summary removal from the board of Southwest, in the context of disagreements

⁵⁶ *Id.*, quoting *Coit v. American Century Corp.*, 1987 Del. Ch. LEXIS 407, *6-7 (Del. Ch. Mar. 20, 1987).

⁵⁷ *Grimes*, 724 A.2d at 565 (“proper purpose has been construed to mean that a shareholder’s *primary purpose* must be proper, irrespective of whether any secondary purpose is proper”).

⁵⁸ The Master denied the defendants’ motion to dismiss in a draft report dated December 22, 2004. The defendants disagreed with the Master’s holding, and attempted to negotiate an arrangement with the plaintiff by which the case would move forward immediately so long as the plaintiff agreed that the defendants’ right to seek review of the Master’s interlocutory decision was not prejudiced. Those negotiations failed. Rather than pursue their exceptions to the Master’s denial of their motion to dismiss, however, the defendants filed their exceptions to the Master’s draft report on January 4, 2005, and then took no further action on that claim. On January 6, the Master issued a letter staying briefing on the exceptions pending the substantive hearing in the case, and trial followed. The defendants now reiterate their argument that the Master erred in failing to dismiss the complaint. But as became clear at oral argument, the defendants proceeded with trial with the full knowledge that they could have raised interlocutory objections to the Master’s draft report at that time, and simply made a choice that trying the case to its conclusion immediately was a more efficient way of proceeding. Tr. of Hearing on Exceptions to the Master’s Report 42:14-17. Having made that choice, the defendants are estopped from claiming now that they reserved their right to challenge the Master’s interlocutory ruling. To allow them to make that argument would not only waste judicial resources, but would reward the defendants with a second bite of the apple for an argument they chose not to make earlier, apparently in the hope that the Master would find in their favor on the merits.

between Martha and the controlling pair of brothers, is evidence of possible wrongdoing. Perry's testimony that he secretly began preparing documents to remove Martha from the board as early as February 2, 2004, and that he executed this maneuver on February 20, 2004, is particularly strong evidence to show possible wrongdoing on the part of Dardanelle's and Southwest's management. Second, the court concurs with the Master that the employment agreements between Perry and Todd and both Southwest and Dardanelle present sufficient suspicion of waste and possible violations of the duty of loyalty to justify a books and records action under Section 220. Most troublesome to the court are the lavish perquisites allowed to Perry and Todd under the employment agreements, which they approved, including access to the company plane, access to effectively free financial services, and access to the Sutherland training facility. Further, the plaintiff has presented credible evidence, through the juxtaposition of the March 17, 2004 letter and her later access to the February employment agreements, that these considerable benefits represent only a part of Perry's and Todd's actual compensation. Together, the credible evidence presented of possible management entrenchment, and possible waste and other breaches of fiduciary duty, clearly provides a sufficient basis for the plaintiff's books and records request.

As to the issue of the plaintiff's actual purpose, the court concurs with the Master that Martha's stated purpose of investigating wrongdoing at Southwest and

Dardanelle is her actual and primary purpose. This is not to say that the court believes Martha's proper purpose as a stockholder is her sole reason for bringing this case. Doubtless, as the Master observed in his draft report, many motivations have precipitated this long and expensive litigation. Specifically, it is evident to the court that an undercurrent of family animosity has contributed to the parties' actions in this case, including the defendants' extremely vigorous defense. But this is not the first case in this court to feature litigants who dislike each other.⁵⁹ Rather, our courts have given credence to such defenses only where it is evident from the facts on the record that the plaintiff's actual, predominating, purpose is something unrelated to the plaintiff's purpose as a stockholder.⁶⁰ In *State ex rel. Linihan v. United Brokerage Co.*,⁶¹ for example, a Delaware court denied a common law motion to inspect books and records where the defendant sufficiently averred that the plaintiff's actual purpose was the "evil and vicious purpose of using this court and its process as a means of coercing . . . [the defendant] to purchase [certain]

⁵⁹ A similar argument was made, and rejected, in *Grimes*, 724 A.2d at 566 ("DSC also argues that, assuming the propriety of Grimes' stated purpose, his actual purpose is improper. DSC points to the fact that Grimes was a large shareholder of DSC but sold all but 1,000 shares of his stock. From this DSC argues that the minimal size of the plaintiff's remaining investment as compared to his wealth, his prior holdings, and the expense of pursuing this litigation, lead to the conclusion that he is not pursuing this case in order to advance his economic interest as a shareholder, . . . [but] as part of a vendetta against DSC and Donald. I cannot accept DSC's argument.").

⁶⁰ *Helmsman Mgmt. Servs. v. A & S Consultants*, 525 A.2d 160, 164 (Del. Ch. 1987).

⁶¹ 101 A. 433 (Del. Super. 1917).

shares of stock.”⁶² And, in the more modern *Helmsman Management Services* case, this court held that a plaintiff’s stockholder interest predominated over its secondary interest in bringing a suit against the same defendant on contractual grounds where the plaintiff already had an extensive opportunity to investigate its contractual claims.⁶³ As the court observed, it made little sense to believe that the plaintiff had brought the Section 220 action primarily to bolster its contract claims because it already had all the information about those claims it needed. The court therefore concluded:

The issue of whether a concept so elusive as purpose or motive is “primary” or “secondary,” involves a judgment that necessarily is qualitative, not mathematical. Specifically, where a stockholder who seeks inspection of books and records has two purposes, one stockholder-related and the other not, the critical inquiry is whether the stockholder-related purpose predominates over the ulterior purpose.⁶⁴

Applying that test, the court ruled that the balance of the evidence showed that the plaintiff’s stockholder-related purpose was the “primary thrust” of his claim.

Similarly, Martha’s Section 220 action appears uniquely irrelevant to her purported ulterior motive of personal animosity. While a Section 220 claim can, as our cases have held, act as leverage where the plaintiff’s real purpose is to pressure the defendant to buy its stock, or to gather information on an unrelated suit, the

⁶² *Id.* at 436.

⁶³ 525 A.2d at 167.

⁶⁴ *Id.* at 167-68.

court finds it difficult to understand how the production Martha seeks could even theoretically act to address Martha's personal grievances towards her brothers. None of the information demanded is personal, or personally embarrassing in any way other than as it relates to Martha's potential fiduciary duty claims. Nor does any of it have anything to do with Norma, or with the trust through which Perry controls the corporations and which supposedly is at the center of Martha's anger. On balance, therefore, while the vehemence of Martha's efforts might have something to do with her animosity towards Perry and Todd, all the evidence supports the conclusion that her primary purpose is to gather information about a corporation in which she is a major stockholder. Martha's primary purpose, thus, is precisely that for which Section 220 is designed.⁶⁵

B. The Scope Of Martha's Inspection

Martha's initial demand letter sought records relating to Perry's and Todd's compensation for a period that predated Dwight Sr.'s death by seven years. The plaintiff argues that such wide-ranging information is necessary because there is a

⁶⁵ *Seinfeld v. Verizon Commnc'ns*, 2005 Del. Ch. LEXIS 185 (Del. Ch. Nov. 23, 2005), on which the defendants rely, concerned dramatically different facts than those at issue here. In that case, a plaintiff filed a Section 220 action seeking to investigate waste, based solely on the fact that three executives at a major publicly traded corporation purportedly received in excess of \$200 million in compensation over several years. The plaintiff there could point to literally nothing other than that bald number, which he derived, for any suspicions of wrongdoing, and indeed admitted that he had no reason to believe that wrongdoing was afoot. The facts here, where a major stockholder of a privately held company seeks to investigate wrongdoing on the basis of specific suspicions, as described in this opinion, present an entirely different situation.

credible basis to believe that Perry and Todd engaged in a number of specific types of corporate mismanagement before voting control of the companies passed to the two brothers upon their father's death. In his November 18, 2005 letter, the Master rejected in part the plaintiff's argument, and held that the delivery of books and records "for the period commencing one full fiscal year before the death of Mr. Sutherland, Sr. . . . to be the proper temporal scope of the right to inspection under § 220 here."⁶⁶ At oral argument, the defendants conceded that if the court held against them on their exceptions, they would have no objection to the one-year period specified by the Master.⁶⁷ The plaintiff, however, maintains her argument that she is due books and records for all seven years.

The parties also disagree as to the scope of categories for which Martha is due books and records. The Master, in his ruling, essentially followed Martha's demand letter, but narrowed that relief to the documents that he found sufficient to fulfill the purpose demonstrated at trial. As with other aspects of this case, the court considers *de novo* the demand letter and its categories of demand.

In general, the scope of relief in a Section 220 action will be limited to the inspection of those books and records that are necessary and essential to the satisfaction of the stated purpose.⁶⁸ The court need not reach that question as to

⁶⁶ *Dardanelle*, 2005 Del. Ch. LEXIS 181 at *5.

⁶⁷ Oral Argument Tr. at 49:5-14.

⁶⁸ *Security First*, 687 A.2d at 570.

paragraph 8 of the demand letter, and as to all other references to Cimarron,⁶⁹ however, because the evidence at trial established only that Dardanelle owned a *portion* of Cimarron.⁷⁰ The Supreme Court has recently held that a court may only order a parent to produce a subsidiary's books and records if "by exercising actual control . . . [the parent] can cause [the subsidiary] to produce its documents."⁷¹ No evidence of such control was presented at trial. Therefore, the court cannot grant relief, in this proceeding, as to that aspect of Martha's request.

All other demands made in Martha's letter, limited temporally as described below, relate directly to the question of whether Perry and Todd, in fact, committed mismanagement and waste. The court notes particularly paragraph 19 of Martha's demand, which seeks "all agendas, minutes, or resolution from any shareholder or director meetings for Dardanelle or SLCO-SW, as well as any notices or unanimous consents relating to any such meetings for the last seven years."⁷² Although the Master did not grant these documents in his final report, the court finds that they clearly coincide with Martha's purpose to investigate mismanagement, and should therefore be produced in connection with this books and records action. Briefly, the evidence at trial demonstrated that Martha was

⁶⁹ Cimarron is implicated in paragraphs 8, 11, 12, 13, 15, 16, 17, and 18 of the July 2004 demand.

⁷⁰ Trial Tr. 78:1-12.

⁷¹ *Weinstein Enters. v. Orloff*, 870 A.2d 499, 510 (Del. 2005).

⁷² JX 1.

removed from the Southwest board in secret, and only discovered this fact when Perry responded to her March 15 email request. It is plainly reasonable to believe, therefore, that the documents contained in paragraph 19 might similarly contain such relevant information and that their absence might prejudice Martha's investigation.

Similarly, the court notes that paragraphs 1, 2, and 3 of the demand letter, which concern Southwest's and Dardanelle's ownership and lease of aircraft, require documents that are clearly central to Martha's investigation. This is because paragraph 4 of the demand, reflected in the Master's final report, grants Martha information relating to Perry's and Todd's personal use of the Sutherland airplane. Paragraphs 2 and 3, therefore, are necessary to allow Martha to investigate whether Perry's and Todd's personal use is out of line relative to business use of the airplane. That question is obviously important to whether a potential claim can withstand a motion to dismiss under Court of Chancery Rule 12(b)(6) and therefore requires to the court to grant those categories of demand.

As to the temporal scope of the books and records claim, the court adopts the Master's decision to award Martha's demand for a period of one full fiscal year before Dwight Sr.'s death. The evidence on the record shows that some of the alleged corporate misconduct at issue might have occurred before the death of Dwight Sr. To the extent it did, information as to those events is closely related to

Martha's investigation. Alternatively, that information might allow Martha to show, by comparing documents from before and after Dwight Sr.'s death, that the genesis of Perry's and Todd's official control of the corporation precipitated the brothers' alleged breaches of fiduciary duty. Granting the full seven years requested by the plaintiff, however, is excessive in relation to the claims raised. There was no evidence to suggest, in particular, that Martha's suspicions of wrongdoing could stretch for the entire period for which she demands documents, including times when her father was in full control of the companies. The credible suspicions of wrongdoing Martha demonstrated at trial, in other words, relate necessarily to Perry and Todd, and the court's order will relate only to those documents necessary to investigate their potential breaches of duty.

VI.

In summary, the court concurs in large part with the Master's conclusions, and hereby orders production of all documents in Martha's demand letter dating from one year before Dwight Sr.'s death, excluding all references to Cimarron for the reasons described above. IT IS SO ORDERED.