



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

MARTHA S. SUTHERLAND,)
)
 Plaintiff,)
)
 v.) C.A. No. 671-N
)
 DARDANELLE TIMBER CO., INC.,)
)
 Defendants.)

Master's Report

Date Submitted: April 6, 2005
Draft Report: April 13, 2005
Final Report: April 25, 2005
(Plaintiff's Motion to Compel)

Charles F. Richards, Esquire, J. Travis Laster, Esquire, Richards, Layton & Finger,
Wilmington, Delaware; Attorneys for Plaintiff.

Robert S. Saunders, Esquire, Jeremy D. Anderson, Esquire, Skadden, Arps, Slate Meagher
& Flom LLP, Wilmington, Delaware, Attorneys for Defendant.

GLASSCOCK, Master

This shall serve as my report on the issue remaining from the plaintiff's motion to compel, following the telephone conference of April 6, 2005. This matter involves a demand under 8 *Del. C.* § 220 to obtain certain records of Dardanelle Timber Company, Inc. ("Dardanelle"). The plaintiff's stated purpose for seeking these records is to investigate wrongdoing of corporate fiduciaries of Dardanelle. Before me is the plaintiff's motion to compel discovery (initially through document requests, modified to include a request for deposition testimony) concerning changes to Dardanelle's certificate of incorporation that modify provisions related to shareholder voting and fiduciary indemnification.¹ These amendments to the certificate of incorporation were made after the demand for inspection at issue here. In addition, the changes to the certificate of incorporation do not directly involve the alleged wrongdoing which production of the documents demanded under § 220 is designed to illuminate: excessive compensation and improper use of company equipment by fiduciaries. Instead, according to the plaintiff, the amendments to the certificate represent

¹ The plaintiff seeks to have the defendants answer document requests 15 and 16 seeking "Any and all documents relating to the preparations for, conduct of and follow-up from Dardanelle's annual shareholder meeting in 2004, including without limitation any and all documents relating to formal and informal agendas for the annual meeting, strategies for Dardanelle's officers and directors for the conduct of the annual meeting, actual or potential talking or speaking points for Dardanelle's officers and directors for the annual meeting, notes, minutes and recordings or transcripts." And

"Any and all documents relating to the amendments in 2004 of the shareholder voting and identification provisions of Dardanelle's certificate of incorporation, including without limitation all documents relating to communications about those amendments and the reasons for the amendments."

post-demand conduct admissible to bolster the plaintiff's alleged proper purpose by evidencing a kind of guilty state-of-mind on the part of the defendants, thereby demonstrating the validity of the plaintiff's concerns about potential wrongdoing. The plaintiff also anticipates that the discovery she seeks will be damaging to the credibility of the defendants, who may testify against her in the § 220 trial.

This latter point, it seems to me, proves too much. If a § 220 plaintiff could use discovery designed to elicit information which might damage the credibility of her opponents in that action, the proper purpose requirement of § 220 would be largely eviscerated.

The plaintiff relies on Marmon v. Arbinet-Theexchange, Inc., Del. Ch., Jacobs, J. (April 28, 2004) (Mem. Op.). Like this case, Marmon involved a demand under § 220 to inspect corporate records based upon allegations of corporate wrongdoing. The plaintiff notes that the Marmon court relied in part upon post-demand behavior—the defendants' stated reason for denying the plaintiff's demand, as well as the defendants' litigation tactic of attempting to demonstrate that no wrongdoing had occurred—to bolster the hearsay evidence of proper purpose for his demand on which the plaintiff relied. The Court noted that the defendants' stated reason for failing to comply with Mr. Marmon's initial document request was that they were prohibited from complying with such requests by small shareholders, a ground that Justice Jacobs found violative of Delaware law. The Marmon court then stated that

“The pretext under which [defendants] sought to litigate a ‘merits’ defense to this claim to inspect books and records in order to investigate possible mismanagement, is that there would

be no ‘credible’ evidence of mismanagement if, in fact, no mismanagement ever occurred. This gambit, if allowed, would turn on its head both § 220 and the case law upholding a books and records inspection for the purpose of investigating mismanagement. In such a case, the issue is whether the evidentiary showing is sufficient to justify a court-ordered books and records inspection to uncover evidence (if any exists) of mismanagement. Under [defendants’] view of the law, a demanding shareholder under § 220 would first have to prove actual mismanagement in order to become entitled to conduct the predicate books and records inspection that would uncover (if it exists) evidence of such mismanagement. Besides being circular and conceptually wrong, that litigation approach is inequitable and subversive of § 220.”

Marmon (Mem. Op.) at 5-6.

The plaintiff here argues that, just as the Marmon court considered post-demand activity of the defendants there, the post-demand activities of the defendants here are relevant to the proper purpose for her own demand, and should therefore be the subject of discovery.

The plaintiff’s reliance on Marmon is misplaced. The Marmon court found the testimony of the plaintiff, although hearsay, sufficient to state a credible allegation of wrongdoing, and noted that his testimony was bolstered by both the stated rationale which the defendants gave to Marmon for refusing to disclose the documents (a rationale the Court found misplaced) and by the defendants’ litigation tactics. However, nothing in Marmon indicates, for instance, that the plaintiff was entitled to take discovery on the defendants’ *true* rationale for withholding the documents, or to inquire as to the reasons for defendants’ choice of litigation strategy. In fact, requiring production of documents and other pre-trial discovery to produce evidence of corporate wrongdoing, on the ground that such wrongdoing would

tend to bolster a showing of proper purpose for a *prior* demand for production of documents to investigate *other* wrongdoing, would invert the § 220 procedure in a manner similar (in scope if not in effect) to that condemned by the Marmon court itself.

The issue for trial is whether the plaintiff had a proper purpose for her demands under § 220. She alleges an interest in investigating corporate wrongdoing, and must demonstrate, therefore, that a credible basis exists to believe such wrongdoing may have occurred. To the extent Marmon is applicable to the actions of the defendants (amending the certificate of incorporation) which underlie plaintiff's motion to compel, it is to indicate that the plaintiff may point to those actions (if relevant) to bolster her showing of proper purpose. Marmon does not persuade me that the discovery sought here is designed to lead to further admissible evidence relevant to a proper purpose, however, and the motion to compel must therefore be denied. Of course, nothing in this report prevents the filing of a separate action, either under § 220 or based on breach of fiduciary duty, arising out of the changes to the certificate of incorporation, to the extent such action is appropriate.

/s/Sam Glasscock, III
Master in Chancery

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