IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

QUANTUM TECHNOLOGY PARTNERS IV, L.P., a Delaware limited partnership,	)	
Plaintiff,	)	
v.	)	C.A. No. 9054-ML
PLOOM, INC., a Delaware corporation,	)	
Defendant.	)	

MASTER'S REPORT
(Post-Trial)

Date Submitted: February 25, 2014
Final Report: May 14, 2014

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LEGROW, Master

This books and records dispute highlights the difficulties that arise when a stockholder in a privately held corporation seeks to exit that investment and demands access to books and records that the stockholder intends to use both to value his stock and to allow prospective purchasers to evaluate an offer. Overlaid on this dispute, variations of which have played out many times in this Court, are additional complications associated with the competitive nature of the company's business and a complete breakdown in trust between the parties.

Although the company professes an interest in allowing the stockholder to divest his holdings, those representations ring hollow when considered in the context of the unreasonable positions taken by the company regarding both the scope of the inspection it would permit and the terms of a confidentiality order it would accept. A more tempered approach likely would have resulted in a settlement more palatable to the company than the inspection I recommend. Instead, the antagonism between parties required trial on, and resolution of, the validity of the plaintiff's purpose, the books and records the plaintiff is entitled to inspect, and the confidentiality terms attendant to the inspection.

For the reasons that follow, I conclude that the plaintiff is entitled to inspect the bulk of the books and records requested in the demand, subject to a confidentiality agreement containing the terms described in this report, and I recommend that the Court enter inspection and confidentiality orders consistent with this report. This is my final report in this matter.

I. Background[1]

The plaintiff, Quantum Technology Partners IV, L.P. ("Quantum") is a Delaware limited partnership that invests in early-stage information technology and life sciences companies and is a record holder of 1,433,658 shares of stock of the defendant, Ploom, Inc. ("Ploom" or the "Company"). Quantum operates as a venture capital firm structured as a "pledge fund" wherein the firm identifies and contracts to invest in projects before soliciting and securing financing from individual partners of the fund.[2] Quantum's general partner is Quantum Technology Management Company IV, LLC ("Quantum LLC"), which is a Delaware limited liability company whose sole managing member is Barry Dickman. Quantum LLC and two of Quantum's limited partners have interests in Quantum's Ploom shares.[3]

Ploom is a privately held Delaware corporation incorporated in 2007, which has as its primary line of business the development, design, manufacture, sale, and distribution of "alternative" tobacco products, including handheld tobacco vaporizers or smokeless

[1] Except as noted, the following facts are not in dispute. In addition, although their testimony largely did not overlap, I found the testimony of the plaintiff's witness, Barry Dickman, generally more credible than that of James Monsees, Ploom's CEO.

[2] Tr. 52–53 (Dickman). Citations in this format are to the trial transcript. Where, as here, the identity of the testifying witness is not clear from the text accompanying the footnote, the witness's surname is indicated parenthetically. *See also* Heather M. Stone, *Five Key Steps to Raising Capital for Private Equity Funds*, 2009 WL 3344395, at *2 (Aspatore) (Oct. 2009) (describing pledge funds).

[3] To the extent necessary, I differentiate between Quantum's holdings in Ploom and Quantum LLC's *interests* in Quantum's Ploom holdings.

tobacco delivery systems.[4] Ploom is part of an emerging market for such products, which includes many of the world's largest tobacco product producing companies.[5]

A. Quantum's Initial Investment in Ploom

Following informal discussions, Quantum and Ploom executed the Series A-3 Preferred Stock Purchase Agreement (the "Purchase Agreement"), dated June 22, 2009.[6] In the Purchase Agreement, Ploom agreed to authorize the issuance and sale of 1,674,460 shares of convertible Series A-3 Preferred Stock ("Preferred Stock"), with 1,004,675 shares earmarked for purchase by Quantum in two closings.[7] The Purchase Agreement required Quantum to close first on 390,707 shares of Preferred Stock for an aggregate price of $350,000.41 (the "First Closing"),[8] followed by a second closing within a specified period of time for an additional 613,968 shares of Preferred Stock for $550,000.52.[9] In addition, the Purchase Agreement provided that Quantum could purchase, without obligation, remaining additional shares that Ploom had not yet sold to another investor.[10]

In connection with the Purchase Agreement, Quantum executed the Amended and Restated Investors' Rights Agreement, also dated June 22, 2009.[11] After completing a strategic investment transaction with JTI, however, Ploom amended this particular

[4] Ploom's Pre-Trial Br. 3.
[5] *See id.* at 3–4.
[6] JX 2. References to "JX" are to the joint exhibits introduced by the parties at the trial held on January 9, 2014.
[7] *Id.* §§ 1.1, 1.3.
[8] *Id.* § 1.3(a). All purchases of Preferred Stock made pursuant to the Purchase Agreement carried a price of $0.895813 per share. *Id.* § 1.2.
[9] *Id.* § 1.3(b).
[10] *Id.* §§ 1.3(c) and (d).
[11] JX 47.

document, which now is the Third Amended and Restated Investors' Rights Agreement (the "IRA"), discussed below.[12]

B. The Parties Execute the Amended Purchase Agreement

Quantum completed the First Closing, but was unable to secure sufficient funds from its partners to complete the second closing.[13] On September 30, 2009, to facilitate further investment, the parties executed the Agreement Regarding Series A-3 Preferred Stock Purchase Agreement (the "Amended Purchase Agreement").[14] That agreement revised the portions of the Purchase Agreement that concerned all transactions other than the First Closing and required that, on October 1, 2009, "[Quantum] shall purchase … an additional 156,283 shares of [Preferred Stock], for an aggregate price of $140,000.35" (the "Second Closing") and, thereafter, required Quantum to close on Preferred Stock in two further tranches: (i) 223,261 shares for $200,000.11 (the "Third Closing"); and (ii) 178,609 shares for $160,000.27 (the "Fourth Closing").[15] If Quantum completed all these required closings, it could purchase up to 675,366 additional shares, or a lesser amount if fewer shares were available.[16]

The Amended Purchase Agreement provided Quantum with board observer rights and allowed it to assert information rights under Section 3 of the IRA, both rights

[12] *See* Ploom's Pre-Trial Br. 6.
[13] Tr. 53–54 (Dickman).
[14] JX 3; Tr. 54 (Dickman); Ploom's Pre-Trial Br. 6–7.
[15] JX 3 § 1(b).
[16] *Id*. § 1(d).

terminable, however, if Quantum failed to complete any of the aforementioned closings or hold at least 546,990 shares of Preferred Stock.[17]

Quantum completed the Second and Third Closings under the Purchase Agreement, but was unable to secure sufficient financing from its partners to make the Fourth Closing.[18] Ploom's trust in Quantum faltered.[19]

C. Quantum's Efforts to Divest Itself of its Ploom Holdings

Since at least January 2012,[20] Dickman actively has sought potential buyers of Quantum LLC's interest in Quantum's Ploom stock, and, in so doing, he has made at least one express offer.[21] In July 2013, Dickman offered to sell to a personal creditor, Rick Lazansky,[22] all of Quantum LLC's interests in Quantum's holdings in Ploom, in consideration for Lazansky forgiving an outstanding promissory note held by Lazansky (the "Lazansky Offer").[23] In addition, the Lazansky Offer gave Lazansky the right to force Quantum LLC to repurchase the shares under certain

[17] *Id*. §§ 3–5.
[18] Tr. 54 (Dickman). At that point, nearly all of Quantum's holdings in Ploom were financed by Quantum LLC. *Id.* ("By the time I got to that point – and to put it in perspective … of the [approximately $690,000] that went in, roughly 96, 97 percent of it, was mine.").
[19] *Id*. 145 (Monsees) (Q. Had a level of distrust developed between the company and [Quantum]? A. Yeah, I think you could say that fairly. I mean, from the beginning … it didn't take long. It was, in fact, almost instantaneous in the relationship that [Quantum] demonstrated an inability to meet negotiated agreements. So there were two major agreements that were breached immediately.").
[20] JX 10.
[21] JX 23; JX 26.
[22] Tr. 10 (Dickman) (noting that Lazansky is a personal creditor of Dickman).
[23] JX 26.

circumstances.[24] To date, Lazansky has not agreed to the terms offered by Dickman, at least in part because Lazansky is skeptical of the price offered by Dickman.[25] Dickman has continued exploring sell terms with Lazansky even up to November 2013.[26] In addition to making the Lazansky Offer, Dickman solicited buy leads from his industry contacts, including those connected to the tobacco industry generally. His contacts identified several potentially interested buyers, but all the parties required additional information regarding Ploom's financials before proceeding to negotiate terms.[27]

In March and August of 2013, Quantum requested by letter access to certain of Ploom's financial information, which Quantum claimed to need to value its interest in the Company.[28] Ploom agreed to provide some of the requested information in response to Quantum's March 2013 request, subject to Quantum's agreement that the information it received would be subject to Section 3.4 of the IRA, which – as described below – precluded Quantum from providing any of the information to a prospective purchaser.[29] There is no evidence in the record that, in attempting to sell Quantum LLC's interest in the Ploom shares, Dickman improperly has divulged any of Ploom's confidential or

[24] JX 26. At trial, Dickman explained that the structure of the Lazansky Offer was uniquely tailored to the fact that both he and Lazansky had insufficient information regarding Ploom's value and outlook to support an agreement that did not enable the buyer to force a repurchase by the seller. Tr. 12–14.
[25] JX 27 ("Chatted with [a Ploom representative] regarding valuation, 409(A) etc. I get a very different opinion on valuation …. The background info I got wasn't consistent with your proposal ….").
[26] *See generally* JX 35.
[27] JX 14, 38.
[28] JX 48, 51, 52.
[29] Compl. Ex. C; Ploom's Pre-Trial Br. at 9-11.

proprietary information;[30] indeed, Dickman has informed at least one potential buy lead that he will provide confidential information only after gaining approval from this Court.[31]

D. The Demand; Ploom's Refusal

On October 21, 2013, Quantum delivered to Ploom a demand to inspect Ploom's books and records pursuant to 8 *Del. C.* § 220 (the "Demand").[32] Citing this Court's decision in *Schoon v. Troy Corp*,[33] Quantum also attached to the Demand a proposed confidentiality agreement.[34]

On October 27, Ploom, through Monsees, responded to the Demand, challenging the propriety of (1) Quantum's purpose, (2) the scope of documents it demanded to inspect, and (3) the proposed confidentiality agreement.[35] As to Quantum's purpose, Ploom noted that, in prior demands, Quantum's stated purpose was to "ascertain the value of its shares" only, yet the most recent Demand states an additional purpose, *i.e.*, to

[30] Ploom points out that, on January 12, 2012, Dickman provided a summary of the terms of Ploom's contractual relationship with JTI to Abeles for the purpose of facilitating Abeles's ongoing investment decisions. JX 10; Tr. 40–43. Abeles, however, is a limited partner of Quantum, and Dickman procured a confidentiality agreement with Abeles. Tr. 42–43. Thus, even under Section 3.4 of the IRA, such action was not improper. *See* JX 4 § 3.4 ("Each Holder acknowledges that the information received by it from the Company may be confidential and for its use only … except … (iv) to any partner … of such Holder for the purpose of evaluating its investment in the Company as long as such partner … is advised and agrees to be bound by the confidentiality provisions of this Section 3.2[sic].").

[31] JX 38.

[32] JX 32. The Demand is dated October 18, 2013, but, according to the Complaint, it was delivered to Ploom's registered agent in Delaware on October 21. Compl. 2 n.1.

[33] 2006 WL 1851481, at *1 (Del. Ch. June 27, 2006).

[34] JX 32, Ex. I.

[35] *See* Compl. Ex. C.

"value [Quantum's] shares *for sale*."[36] In addition, Ploom suggested that the Demand was part of an "ongoing effort to make itself a nuisance so that perhaps Ploom or Ploom's investors will become frustrated and want to repurchase [Quantum's] shares."[37] On these bases, Ploom alleged that Quantum's stated purpose was improper or illusory.

Regarding the scope of Quantum's demanded inspection, Ploom refused to produce all the documents except (1) "a list of all of [Ploom's] stockholders … with the names and addresses of the stockholders, but … [no] other information"; (2) Ploom's "last unaudited annual financial statements, those for 2012"; and (3) Ploom's "latest 409A valuation,"[38] on the basis that the Demand exceeded the bounds of Delaware law.[39] In addition, Ploom asserted that the 2012 409A Valuation that it already had produced sufficiently reflected all the demanded financial information, and that, in any event, the Demand could not be used to circumvent Quantum's loss of its contractual information rights under Section 3 of the IRA, the scope of which probably would have been wider than under Section 220.[40]

Finally, Ploom rejected outright Quantum's proposed confidentiality agreement, stating affirmatively that "Ploom will not permit the disclosure of its confidential information to third parties" because "shar[ing such] information with third parties and even 'Highly Confidential Information' with Ploom competitors … is absurd for a

[36] *Id.* at 1 (emphasis added).
[37] *Id.* at 3 (citing *Am. Carriers, Inc. v. Baytree Investors, Inc.*, 685 F. Supp. 800 (D. Kan. 1988); *State ex rel Nat'l Bank v. Jessup & Moore Paper Co.*, 88 A. 449 (Del. Super. 1913)).
[38] *Id.* at 3–4.
[39] *Id.* at 2 (citing *Golden Cycle, LLC v. Global Motorsport Gp., Inc.*, 1998 WL 326680, at *1 (Del. Ch. June 18, 1998)).
[40] *Id.* at 2.

technology company, as Quantum is aware ….”[41] On this issue, Ploom also noted that Quantum already is bound by the confidentiality terms contained in Section 3.4 of the IRA.[42] In view of this letter, Quantum commenced this suit on October 31, 2013.

In advance of trial, Ploom developed its own proposed confidentiality agreement, which differed in several significant respects from the one proposed by Quantum. The parties, however, did not engage in any substantive negotiation regarding the terms of a confidentiality agreement. In fact, the parties' pre-trial submissions did not even take the elemental step of providing a blackline showing the differences between the two proposed agreements. For that reason, at the conclusion of trial, I instructed the parties to discuss the confidentiality order and attempt to narrow their disputes.[43] I also provided guidance regarding some of the obvious areas of disagreement, including the definitions of "competitor," "confidential information," and "highly confidential information," an attorneys' fees clause, and proposed restrictions on who qualified as a potential purchaser or financial advisor. My instructions notwithstanding, the parties did not engage in the type of good faith meet and confer discussions envisioned or expected by the Court, which is all the more surprising and disappointing given the caliber of counsel representing the parties. For that reason, the parties' post-trial submissions, while containing the requested blacklines, do not otherwise reflect the type of compromise and movement that often results when counsel participate in discussions in-person. Instead, the parties merely exchanged by e-mail competing versions of a confidentiality

[41] *Id*. at 3.
[42] *Id.* at 3.
[43] Trial Tr. at 188-191.

agreement, blacklined these versions, and argued to the Court why their version should be adopted wholesale. Much of this report, therefore, is spent crafting a confidentiality agreement on the parties' behalf.

II. Legal Analysis

A. Evidentiary Objections

Before turning to the substantive issues, I must address briefly Quantum's evidentiary objections and Ploom's motion to seal or redact portions of the trial exhibits and the trial transcript.

1. Quantum's Objections

At trial, Ploom moved to admit Exhibits 48, 50, 51, and 52 for the purpose of demonstrating that Section 3.4 of the IRA governs – or, more aptly, limits – Quantum's ability to share any information that might be produced as a result of this action. Exhibit 48 is the inspection demand made by Quantum on March 15, 2013. Exhibits 50, 51, and 52 are responsive letters sent by or on behalf of Quantum agreeing, in pertinent part, that Section 3.4 of the IRA would govern Quantum's use of any confidential information provided to it by Ploom pursuant to the relevant demands.

Essentially, Ploom asserted at trial that these documents demonstrate that Section 3.4 of the IRA governs any inspection of books and records compelled in this action solely because they show that Quantum has agreed to that in the past. For its part, Quantum objects to the admission of these documents on the basis that Section 3.4 of the IRA, by its plain meaning, does not govern any inspection compelled in this action, and,

therefore, Exhibits 48, 50, 51, and 52 are irrelevant and should not be admitted for that purpose.

Ploom's reliance on this extrinsic evidence to support its proffered interpretation of the IRA is not permitted under settled Delaware law. In interpreting a contract, the overriding principle is the parties' intent.[44] Delaware courts adhere to the objective theory of contract construction, *i.e.*, courts first will look to the terms of the agreement, ascribing to the words "their common or ordinary meaning, and interpret[ing] them as would an objectively reasonable third-party observer."[45] Thus, courts admit extrinsic evidence only if the contract at issue is ambiguous.[46]

Here, I find that Section 3.4 of the IRA is not ambiguous. That Section reads:

> The Company shall not be required to comply with any information rights of Section 3 in respect to any [holder of registerable Ploom securities ("Holder")] whom the Company reasonably determines to be a direct competitor or an officer, employee, director or holder of more than 5% of the outstanding capital stock of a direct competitor. Each Holder acknowledges that the information received by it from the Company may be confidential and for its use only, and it will use reasonable care not to use any such information that the Company labels as being confidential in violation of the Exchange Act or reproduce, disclose or disseminate such information to any other person (other than its employees or agents having a need to know the contents of such information, and its attorneys), except (i) in connection with the exercise of rights under this Agreement, (ii) if the Company has made such information available to the public

[44] *Sassano v. CIBC World Markets Corp*., 948 A.2d 453, 462 (Del. Ch. 2008) (citation omitted).
[45] *Id.* (internal quotations omitted). *See also Eagle Indus., Inc. v. DeVilbiss Health Care, Inc*., 702 A.2d 1228, 1232 (Del. 1997) ("Contract terms themselves will be controlling when they establish the parties' common meaning so that a reasonable person in the position of either party would have no expectations inconsistent with the contract language.")
[46] *GMG Capital Invs., LLC v. Athenian Venture P'rs I, L.P*., 36 A.3d 776, 780 (Del. 2012).

> generally, (iii) if such Holder is required to disclose such information by a governmental authority pursuant to legal process, (iv) to any partner, subsidiary or parent of such Holder for the purpose of evaluating its investment in the Company as long as such partner, subsidiary or parent is advised and agrees to be bound by the confidentiality provisions of this Section 3.2; (v) at such time as it enters the public domain through no fault of such Holder; (vi) that is communicated to it free of any obligation of confidentiality; or (vii) that is developed by such Holder or its agents independently of and without reference to any confidential information communicated by the Company.[47]

By its terms, Section 3.4 unambiguously refers and applies only to confidential information that is produced by Ploom pursuant to Section 3 of the IRA, which, in broad stroke, outlines specific inspection rights granted to certain investors.[48] In this action, Quantum seeks to compel inspection of certain information under 8 *Del. C.* § 220, a right it possesses independent of the IRA and which Quantum expressly retained even after it lost its rights under Section 3 of the IRA.[49] Because Section 3.4 is not ambiguous, I need not and cannot consider extrinsic evidence of its application.

The conclusion that Section 3.4 of the IRA does not limit Quantum's rights under Section 220 of the Delaware General Corporation Law ("DGCL") separately is compelled by this Court's decision in *Schoon v. Troy Corp.*,[50] wherein the Court held that a waiver of a statutory right must be expressed "clearly and affirmatively" in the relevant

[47] JX 4 § 3.4; *see also id.* § 1.1(f).
[48] *See* JX 4 §§ 3.1, 3.2.
[49] Tr. 62–63 (Dickman) (explaining that Quantum never has agreed to waive its rights under Section 220); s*ee also* JX 3 § 5 ("For avoidance of doubt, the elimination of Quantum's rights under Section 3 of the IRA referenced in this Section 5 shall not constitute a waiver of Quantum's right as a stockholder to pursue inspection of books and records under Section 220 of the Delaware General Corporation Law.").
[50] 2006 WL 1851481, at *1 (Del. Ch. June 27, 2006).

document.[51] Interpreting Section 3.4 as Ploom suggests effectively would limit Quantum's rights under 8 *Del. C.* § 220, but the IRA does not do so clearly or affirmatively. Accordingly, even if Section 3.4 were ambiguous, it cannot, as a matter of law, govern any statutory inspection of Ploom's books and records. As discussed below, and under established Delaware law interpreting Section 220(c), this Court may condition inspection on execution of a confidentiality agreement, but one as restrictive as Section 3.4 would not be a proper exercise of the discretion afforded this Court by the statute.

Although I will not consider Exhibits 48, 50, 51 and 52 as parol evidence relevant to the interpretation of Section 3.4, those exhibits may bear on the Court's consideration of (1) Quantum's purpose, (2) whether Quantum's conduct supports a particular confidentiality restriction, and (3) what information Quantum already has received, and the exhibits should be admitted for those purposes.

2. Ploom's Motion to Seal or Redact

Before trial, Ploom moved to seal Exhibits 5, 16, and 17 and to redact portions of Exhibits 2, 4, 6, 9, 10, 11, 12, 19, and 24, all on the basis that the information in those exhibits is confidential, proprietary, and its disclosure would be detrimental to Ploom's business. At trial, only Exhibits 2, 4, 10, 16, 17, and 24 were moved into evidence, and Ploom therefore limited its motion to those exhibits.

Exhibits 16 and 17 contain voluminous financial information concerning a valuation performed for Ploom pursuant to Section 409A of the Internal Revenue Code (the "2012 409A Valuation"). Considering Ploom's status as a close corporation and its

[51] *Id.* at *2 (citing *Kortum v. Webasto Sunroofs, Inc.*, 769 A.2d 113, 125 (Del.Ch. 2000)).

position in an emerging marketplace, I find that Ploom's interest in maintaining the confidentiality of these documents outweighs the public's interest in viewing the information.[52] This is particularly true because the information contained in Exhibits 16 and 17 largely is irrelevant to my recommendation, and therefore would not illuminate the public's understanding of this dispute.[53] I therefore recommend that the Court grant Ploom's motion as to these documents.

Ploom has moved to redact information contained in Exhibits 2, 4, 10, and 24 relating to (1) the number of shares held by its investors, as reflected in these documents, and (2) the terms of Ploom's contractual relationship with Japan Tobacco Company ("JTI"). Because evidence of the terms of Ploom's relationship with JTI carries little weight in my recommendations in this case, and because of the sensitivity of this information to Ploom's ongoing operations, I recommend that the Court grant this aspect of Ploom's motion to redact. As to the information reflecting the number of shares held by its investors, however, I do not find that Ploom's interest in maintaining the confidentiality of this information outweighs the public's interest in placing it on the public record. Put simply, Ploom has not cited controlling statutes, cases, or agreements for the proposition that Ploom's "responsibility to maintain information regarding other stockholders as confidential," without more, justifies concealing this information from the public record. I recommend that the Court deny that aspect of Ploom's motion.

[52] *See generally* Ct. Ch. R. 5.1(b)(2).
[53] *See Al Jazeera Am., LLC v. AT & T Servs., Inc.*, 2013 WL 5614284, at *5 (Del. Ch. Oct. 14, 2013) (considering whether allegedly confidential information goes to the public's understanding of the dispute before the Court).

Additionally, in its post-trial letter submission, Ploom moved to redact portions of pages 30–32, 38, 40, 114–15, 167, and 168 of the trial transcript. For the reasons stated above, I grant Ploom's motion as to pages 30–32, 38, 40, 114–15, which contain confidential and proprietary information that was derived from the 2012 409A Valuation or reflects the terms of Ploom's agreements with JTI. Moreover, although pages 167 and 168 reflect Monsees's personal holdings in Ploom – which generally I find not to be so confidential as to justify redacting it from the trial record – I grant this aspect of Ploom's motion on the basis that Quantum agreed at trial to strike its questions concerning this information.

B. Inspection Standard

Stockholders of Delaware corporations enjoy a qualified statutory right to inspect the corporation's stock ledger, a list of its stockholders, and its other books and records.[54] Inspection rights first "were recognized at common law because, '[a]s a matter of self-protection, the stockholder was entitled to know how his agents were conducting the affairs of the corporation.'"[55] This common law right was codified in 1967 in 8 *Del. C.* § 220, which imposes both procedural and substantive requirements on a stockholder proceeding under that Section.[56]

To satisfy Section 220's procedural requirements, *i.e.*, its "form and manner" requirements, demand must be made in writing, under oath, and must state the

[54] *Saito v. Mckesson HBOC, Inc.*, 806 A.2d 113, 116 (Del. 2002); 8 *Del. C.* § 220(b).
[55] *Saito*, 806 A.2d at 116 (quoting *Shaw*, 663 A.2d at 467).
[56] *Cent. Laborers Pension Fund v. News Corp.*, 45 A.3d 139, 143 (Del. 2012).

stockholder's purpose for making it.[57] In addition, a demand must be directed to the corporation at its registered office in Delaware or at its principal place of business, and, if demand is made through an agent or attorney, it must be "accompanied by a power of attorney or such other writing which authorizes the attorney or other agent to so act on behalf of the stockholder."[58]

Where the corporation refuses to permit the demanded inspection, or fails to reply within five business days after demand has been made, the stockholder may petition this Court in a summary proceeding to compel such inspection.[59] In all instances, it is incumbent on the petitioner to establish its ownership of stock in the target corporation and its compliance with the statute's form and manner requirements.[60] Where the stockholder seeks to inspect the corporation's stock ledger or list of stockholders, Section 220 imposes on the corporation opposing such inspection the burden of establishing that the stockholder's purpose is improper.[61] On the other hand, where the stockholder seeks to inspect books and records *other* than the corporation's stock ledger or list of stockholders, it is the stockholder who must establish the propriety of the stated purpose.[62]

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[57] 8 *Del. C.* § 220(b).
[58] *Id.*
[59] *Id*. § 220(c).
[60] *See id.* Here, Ploom has not challenged whether Quantum has satisfied the form and manner requirements in making its Demand. In any event, after carefully reviewing the record before the Court, I find that Quantum has done so.
[61] *Id.*
[62] *Id.*

C. The Proper Purpose Requirement

A stockholder's purpose is "proper" if it is "reasonably related to such person's interest as a stockholder."[63] In addition, the purpose must not be adverse to the company, nor may the information be requested "out of sheer curiosity, unrelated to any legitimate interest of the stockholder, or where the sole purpose of the inspection is to harass the corporation."[64] Stockholders may have multiple purposes for demanding inspection of a corporation's books and records, and the Court may inquire into the *bona fides* of the stockholder's primary purpose.[65] Once the Court determines that the stockholder's primary purpose is proper, however, the existence or propriety of any secondary purposes is irrelevant,[66] except that, as discussed herein, any such secondary purposes may be relevant in determining the scope of the inspection.[67]

It is settled law that the valuation of one's shares is a valid purpose to inspect books and records.[68] Because minority stockholders of privately held corporations "do not receive the mandated, periodic disclosures associated with a publicly held corporation, [those stockholders] face certain unique risks."[69] Minority stockholders in private corporations may "have a legitimate need to inspect the corporation's books and records to value their investment, in order to decide whether to buy additional shares, sell

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[63] *Id*. § 220(b).
[64] *CM & M Gp., Inc. v. Carroll*, 453 A.2d 788, 792 (Del. 1982).
[65] *See Magid v. Acceptance Ins. Cos*., 2001 WL 1497177, at *5–6 (Del. Ch. Nov. 15, 2001).
[66] *CM & M Gp., Inc.*, 453 A.2d at 792; *Caspian Select Credit Master Fund Ltd. v. Key Plastics Corp*., 2014 WL 686308, at *4 (Del. Ch. Feb. 24, 2014).
[67] *Helmsman Mgmt. Servs., Inc. v. A & S Consultants, Inc.*, 525 A.2d 160, 167 (Del. Ch. 1987).
[68] *CM & M Gp., Inc.*, 453 A.2d at 792.
[69] *Thomas & Betts Corp. v. Leviton Mrg. Co.*, 685 A.2d 702, 713 (Del. Ch. 1995).

their shares, or take some other action to protect their investment."[70] In addition, where the alleged purpose is to explore a possible sale of stock, Section 220(c) does not require the stockholder to have taken concrete steps to sell the stockholder's shares before relying on that purpose as a basis for seeking inspection.[71]

Even if a stockholder states a proper purpose, he is entitled to inspect only those records that are "essential and sufficient" to achieve his purpose.[72] A document is "essential" under Section 220 if "it addresses the crux of the shareholder's purpose," and the "information the document contains is unavailable from another source."[73] Put another way, stockholders seeking to inspect books and records must specifically and discretely identify, with "rifled precision," the documents sought.[74] This inquiry necessarily depends on the context of each case.[75]

In defining the scope of an inspection, the Court may consider whether the corporation previously furnished information to stockholders,[76] and any ulterior motives of the stockholder demanding inspection.[77] Thus, the stockholder generally cannot compel inspection to the extent the information already has been received.[78]

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[70] *Thomas & Betts Corp.*, 685 A.2d at 713. *See also Macklowe v. Planet Hollywood, Inc.*, 1994 WL 560804, at *4 (Del. Ch. Sept. 29, 1994) ("When a minority shareholder in a closely held corporation whose stock is not publicly traded needs to value his or her shares in order to decide whether to sell them, normally the only way to accomplish that is by examining the appropriate corporate books and records.").
[71] *Macklowe*, 1994 WL 560804, at *4.
[72] *Id*. at *6; *see* 8 *Del. C.* § 220(c).
[73] *Espinoza v. Hewlett-Packard Co.*, 32 A.3d 365, 371–72 (Del. 2011) (citations omitted).
[74] *Sec. First Corp. v. U.S. Die Casting and Dev. Co.*, 687 A.2d 563, 570 (Del. 1997).
[75] *Espinoza*, 32 A.3d at 372.
[76] *Radwick Pty, Ltd. v. Med. Inc.*, 1984 WL 8264, at *3 (Del. Ch. Nov. 7, 1984).
[77] *Helmsman Mgmt. Servs., Inc. v. A & S Consultants, Inc.*, 525 A.2d 160, 167 (Del. Ch. 1987).
[78] *See Mercantile Trading Co. v. Rosenbaum Grain Corp.*, 154 A. 457, 460 (Del. Ch. 1931).

D. Quantum Has Stated a Proper Purpose

Quantum has demanded to inspect certain of Ploom's books and records to: "(1) determine the value of its Ploom shares, (2) solicit buyers of its Ploom shares, and (3) evaluate offers to purchase its Ploom shares."[79]

Quantum must be in a position to value its Ploom shares before Quantum can solicit buyers and evaluate purchase offers. Although Quantum previously sought and received limited financial information in order to value its shares, Dickman credibly testified at trial that the information is both stale and incomplete. In addition, the information Ploom previously provided Quantum is subject to strict confidentiality terms that prohibit Quantum from sharing the information with potential purchasers. For those reasons, the information Quantum previously received does not alter my analysis of either the propriety of Quantum's purpose or the scope of the inspection that should be permitted.

In addition, although he has not received any concrete offers, the record amply demonstrates that Dickman actually has pursued potential buyers of Quantum LLC's interests in Quantum's Ploom stock. One of Quantum's contacts, in fact, has indicated its intent to negotiate sale terms in the near future.[80] Ploom asserts, however, that Quantum instituted this action to harass the Company into repurchasing Quantum's shares.[81] I find this position unpersuasive, in part, because of the record evidence demonstrating

[79] Demand 2.
[80] JX 38 (e-mail from Mansfield to Dickman, dated December 5, 2013) ("Good luck in court. I believe the people we are speaking to are serious and reasonable. Certainly if the price is not right for you there is no need for you to sell.").
[81] Compl. Ex. C., at 3.

Dickman's intent to sell Quantum LLC's interests to a third party. In addition, throughout trial, Dickman testified credibly and in detail why each of the categories of the demanded information – which Ploom has refused to produce – is essential to the valuation of Quantum's holdings in Ploom. This is in sharp contrast to the facts in *Neely v. Oklahoma Publishing Co.*,[82] where the stockholder plaintiff sought a thorough examination of "*any and all company records and minutes*" to "ascertain that price which would be in her best interest to ask of a prospective buyer," even after she already had received considerable documentation.[83]

E. The Scope of Quantum's Inspection

Because the Demand states a proper purpose, Quantum is entitled to inspect the books and records that are essential and sufficient to its purpose. In all, Quantum has demanded to inspect nine categories of documents. I address each of the categories *seriatim*.

As an initial matter, however, I find unpersuasive Ploom's contention that it should not be compelled to make available for inspection certain sensitive and proprietary information, ostensibly because Ploom does not trust that Quantum will protect Ploom's confidentiality,[84] or because Ploom does not wish to concede ground in potential repurchase negotiations with Quantum.[85] The record demonstrates, and Ploom has failed to refute, that Quantum has abided by its past agreement to maintain the confidentiality of

[82] 1977 WL 2563 (Del. Ch. 1977).
[83] *Id.* at *1 (emphasis added).
[84] Ploom's Pre-Trial Br. 11–12; Tr. 146, 178 (Monsees).
[85] Ploom's Pre-Trial Br. 18.

Ploom's sensitive information. Ploom has not cited any case in support of the proposition that this Court should curtail a stockholder's statutory right to inspect books and records that, although necessary and essential to the valuation of its shares, would diminish the company's ability to preserve its higher ground in arm's length negotiations to repurchase shares from the petitioning stockholder.[86] Without more, whether Ploom intrinsically trusts Quantum is irrelevant. Moreover, to the extent that certain information, if divulged to third parties, would be detrimental to Ploom, those concerns are addressed by entry of a proper confidentiality order.

1. The Stockholder List

The first category of Quantum's demand seeks "[a] complete record or list of the record holders of Ploom's common stock, certified by Ploom or its transfer agent, showing the name, address, and number of shares registered in the name of each such holder as of the date hereof." Ploom has agreed to provide Quantum with a complete list of Ploom's stockholders as of the date of the Demand.[87] For the reasons explained below, the information Ploom provides in response to this category should be current as of, or close to, the date of inspection, not the date of the Demand.

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[86] In Ploom's letter dated October 28, 2013, refusing the Demand, the company cited *State ex rel. National Bank v. Jessup & Moore Paper Co.*, 88 A. 449 (Del. Super. 1913) for the proposition that a stockholder cannot trigger its inspection rights purely as a measure to annoy the company into repurchasing the stockholder's shares. Compl. Ex. C, at 3. Ploom's citation to this case is unavailing. As the *Jessup* court noted, for a court to deny inspection on such a basis, the stockholder must have engaged in the subject litigation in bad faith. *Jessup*, 88 A. at 450. Here, although Ploom may not appreciate Quantum's tactics in seeking to inspect certain books and records, there is no evidence supporting the conclusion that Quantum has demanded such inspection in bad faith. What is more, because I find that, as discussed *infra*, Quantum legally is entitled to nearly all the information it has demanded, I cannot also find that this suit has been instituted in bad faith.

[87] Pre-Trial Stip. & Proposed Order ("PTO") ¶ II.L.

2. Ploom's Annual Financial Statements

Quantum next demands to inspect "Ploom's audited annual financial statements for each of the last three fiscal years and, to the extent that audited financial statements are not available, Ploom's unaudited annual financial statements for each of the last three fiscal years." Ploom has agreed to provide Quantum with unaudited annual financial statements for 2010 and 2011 and its audited annual financial statement for 2012 when it becomes available.[88] As explained in Section II.E.9., I find that Quantum also is entitled to inspect Ploom's audited annual financial statement for 2013, or, to the extent an audited financial statement is not available, the 2013 unaudited annual financial statement.

3. Ploom's Periodic Financial Statements

Category 3 of the Demand seeks "Ploom's periodic financial statements for all periods [following] the last financial statement produced in response to [Category] 2." Ploom has agreed to provide Quantum with the Company's quarterly financial statement for the quarter ending September 30, 2013, to be in the same form as its annual financial statements.[89] This agreement, however, has been rendered stale by the passage of time. Because Ploom almost certainly has prepared its 2013 financial statement, which I have concluded it should produce, the only quarterly statement at issue at this point is the first quarter of 2014.

[88] *Id*. ¶ II.M.
[89] *Id*.

As a general matter, this Court may conclude, in its discretion, that a stockholder is entitled to updated information pursuant to an inspection granted under 8 *Del. C.* § 220.[90] As the Supreme Court cautioned in *Carroll*, "[i]t is a contradiction to conclude, on the one hand, that certain books and records must be produced for inspection and copying because they are 'essential' to the valuation and the particular difficulties of the sale of [the stockholder's] shares but, on the other hand, to limit such inspection to a single time."[91] Thus, where the stockholder has sought books and records as part of a sales effort, "subsequent updated information must be deemed equally 'essential' in valuing his shares – without the necessity of instituting new actions periodically for that purpose."[92]

Ploom's agreement to provide quarterly financial statements post-dating its last annual statement extends, with the passage of time, to the first quarter of 2014, and even if Ploom's stipulation cannot fairly be read in that way, Quantum has established that quarterly statements for the periods after the last annual statement are essential to its stated purpose. Specifically, Dickman has explained – and Ploom has not refuted – that Ploom's finances and business fluctuate unpredictably.[93] I disagree, however, with

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[90] *See CM & M Gp., Inc. v. Carroll*, 453 A.2d 788, 794 (Del. 1982); 8 *Del. C.* § 220(c) ("The Court may, in its discretion, prescribe any limitations or conditions with reference to the inspection.").

[91] *CM & M Gp., Inc.*, 453 A.2d at 794.

[92] *Id.*

[93] *E.g.*, Tr. 21 ("In the case of high-growth, early-stage companies, it's the complete opposite. There's very much potential growth, volatility and, in fact, things can change on a monthly basis that could be very significant."); *id*. 22 ("And the growth rate is something that can be – can happen – can be a very material change in a very short amount of time …. [And] little start-up companies – and Ploom is a good example – can have significant growth in very short periods of time."); *id*. 56 ("And we actually got to the point where if I wrote the check, the company potentially would then become insolvent upon a small number of months after receiving my check.").

Dickman's assertion that Quantum requires monthly financial statements for the purpose of remaining "current" even after the latest quarterly financial statement has been made available.[94] Although monthly financial statements may be desirable or helpful, Quantum has not demonstrated that monthly financial statements are essential to its valuation of Ploom.[95] In addition, Quantum has not shown that Ploom formally produces such reports in the ordinary course of business.

4. Tax Returns

In category 4 of the Demand, Quantum seeks "Ploom's federal and state income tax returns for each of the last three fiscal years." Quantum contends that Ploom's tax returns are essential to valuing the Company because the returns likely will contain certain key information not available in Ploom's financial statements, such as: (1) statements of royalty income; (2) information relating to Ploom's international activities undertaken with JTI; and (3) Ploom's net operating losses.[96] In addition, because Ploom has not yet completed an audit, Dickman explained that Ploom's tax returns are the "next best thing as far as a proxy for the signature [of an officer],"[97] which is important to potential buyers.[98] Although the availability of audited financial statements for 2012 (and, presumably, 2013) addresses the latter issue, Quantum has shown that the absence of certain key information from the financial statements makes the tax returns necessary to valuation and sale of the stock.

[94] Tr. 22–23.
[95] This Court compelled a similar result in *Neely v. Okla. Publ'g Co.*, 1977 WL 2563, at *3-4 (Del. Ch. Aug. 15, 1977).
[96] Tr. 23–24 (Dickman).
[97] Tr. at 24–25.
[98] *Id*. at 25.

5. Valuations

Quantum next seeks to inspect "[a]ll valuations of Ploom, its stock, or its assets created, developed, or disseminated from January 1, 2011, through the date [of the Demand]." Ploom maintains that it "should not be required to incur the burden of producing [these] documents so [Quantum] can [validate] its own valuation,"[99] although Ploom has agreed to provide Quantum with the Company's next 409A valuation, when available.[100] As noted, Quantum possesses Ploom's 2012 409A Valuation. Quantum, however, contends that, although some of the information contained in the report is useful,[101] its overall design is governed by its purpose – to establish a strike price for Ploom's option grants – which renders the valuation within it not comparable to the value placed on the stock in an arms-length transaction.[102] In addition, I credit Dickman's testimony that the 2012 409A Valuation that Ploom already has produced is out-of-date and that Quantum requires more current information to establish a present value for sale.[103]

In short, I find that Quantum sufficiently has demonstrated that documents associated with this category, including, but not limited to, the next available 409A

[99] Ploom's Pre-Trial Br. 18–19.
[100] PTO ¶ II.N.
[101] Tr. 29 (Dickman).
[102] *Id*. at 28, 30-32. *See also* JX 17, at ii (qualifying that the 2012 409A Valuation's "materials and [] conclusions are intended to be used by the Board of Directors and Management of the Company for the exclusive purpose of compliance with IRC §409A," and that the drafters of the valuation "make no representation as to the accuracy of this [o]pinion if it is used for any other purpose without the written consent of [the drafters]."). Also, in support of his contention that the 2012 409A Valuation is unreliable as a standalone valuation, Dickman challenged the companies used in the analysis as "comparables" for Ploom. Tr. 30.
[103] Tr. 26, 31.

valuation,[104] are essential to achieving its primary purpose. I also find, however, that Quantum's request for *all* valuations "created, developed, or disseminated," is too broadly framed. For example, taken literally, Quantum has demanded valuations that were created but never finalized, or that might pertain to particular assets that are not essential to Quantum's purpose of valuing its stock in Ploom. This Court may, in view of its authority to "protect the corporation's legitimate interests and to prevent possible abuse of the shareholder's right of inspection,"[105] prescribe any limitations or conditions with reference to the inspection.[106] I therefore find that Quantum is entitled to inspect only those valuations that Ploom created or developed *and* that actually were disseminated by or to Ploom's officers or directors, even if only internally, for the purpose of assessing Ploom's value or the value of its assets.

6. Forecasts and Projections

The sixth category of the Demand seeks "All financial forecasts or projections for Ploom created, developed, or disseminated from January 1, 2011, through the date [of the Demand]." In support of its request for information in this category, Quantum contends that the management projections, *e.g.*, anticipated growth rates, sales, earnings, and margins comprising these documents are, perhaps, "the biggest indicator [of] the value of the stock for a small company."[107] The relative value of this information is heightened in

[104] In any event, Ploom has agreed to make this document available to Quantum. PTO ¶ II.N.
[105] *CM & M Gp., Inc. v. Carroll*, 453 A.2d 788, 793–94 (Del. 1982) (citation omitted).
[106] 8 *Del. C.* § 220(c).
[107] Quantum's Pre-Trial Br. 26 (quoting Dickman Dep. 179); Tr. 33–34 (Dickman). At trial, Dickman also noted that the management forecasts that Quantum seeks would include other vital information such as forecasting of cost of goods, operating expenses, and taxes, all of which are part of a mix of information critical in valuing a company such as Ploom. Tr. 34.

the context of early stage development companies. For its part, Ploom argues that the information sought in this request would be redundant of the information in the 2012 409A Valuation and Ploom's 2012 year-end unaudited financial statement, and in any event, Quantum can look to historical information or publicly available market analyst reports to assess Ploom's relative position in the larger e-cigarette and tobacco markets.[108]

Quantum is entitled to the information sought in this category. The importance of forecasts and projections to valuation of a company is so basic that it does not require citation.[109] Quantum also has shown that other forecasts or projections, apart from those in a 409A valuation, are essential to valuing and selling the stock. The purpose of a 409A valuation raises questions about its reliability as a source for valuing stock in an arms-length sale. In addition, Ploom has not demonstrated that the information contained in the 2012 409A Valuation sufficiently reflects all the types of information that are essential for Quantum to value its shares in Ploom as a going concern. Nor has Ploom demonstrated how historical information or publicly available market analyses are an analogue to actual management forecasts.

I recommend to the Court, however, that Quantum's inspection of documents in this category be limited in the same manner as recommended in category 5, particularly in view of the category 6's equally broad language. That is, Quantum should be entitled

[108] *See* Monsees Dep. 194–95.

[109] Nevertheless, s*ee, e.g.*, *In re BioClinica, Inc. S'holder Litig.*, 2013 WL 673736, at *5 (Del. Ch. Feb. 25, 2013); *In re Netsmart Techs., Inc. S'holders Litig.*, 924 A.2d 171, 203 (Del. Ch. 2007); *Dobler v. Montgomery Cellular Holding Co.*, 2001 WL 1334182, at *8 n.31 (Del. Ch. 2001).

to inspect those forecasts and projections that Ploom created or developed *and* that actually were disseminated by or to Ploom's officers or directors, even if only internally, for the purpose of addressing management's outlook on Ploom's business.

7. Transactions involving Ploom's stock

Category 7 of the Demand seeks "[a]ll materials relating or referring to any transaction involving Ploom's stock, whether or not Ploom was a party to such transaction, from January 1, 2011, through the date [of the Demand]," while category 8 seeks "[a]ll materials relating, referring, or constituting any offer or proposal to buy or sell Ploom's stock, whether or not such proposals were directed to Ploom, from January 1, 2011, through the date [of the Demand]." Quantum seeks the information requested in categories 7 and 8 because "the price at which an asset changes hands is highly probative of its value."[110] In support of its position, Quantum cites this Court's decision in *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*,[111] where the Court noted that "[i]n the real world, market prices matter and are usually considered the best evidence of value."[112] For its part, Ploom maintains that Quantum seeks documents in these categories merely to serve as a helpful crosscheck to Quantum's internal valuations. Ploom therefore maintains this information is not *essential* to Quantum's stated purpose.

Quantum has established that the information demanded in these categories is essential to achieving its primary purpose, particularly given the rather narrow market for Ploom's stock, the Company's relatively short existence, and the fact it only recently has

[110] Quantum's Pre-Trial Br. 28.
[111] 855 A.2d 1059, 1080 (Del. Ch. 2003), *aff'd*, 840 A.2d 641 (Del. 2003).
[112] *Id.* at 1080.

begun marketing products. I therefore recommend that the Court compel the inspection, but I agree with Ploom that these requests are overly broad. I recommend that, in both categories 7 and 8, the Court replace the language "relating, referring, or constituting" with "sufficient to reflect the terms of."

8. The JTI documents

The final request in the Demand is by far the most contentious, and calls for "[a]ll materials relating, referring, or constituting contracts or agreements between Ploom and [JTI], and each of their respective subsidiaries and affiliates." Quantum contends this information is critical to valuing Quantum's shares in Ploom because the nature and terms of Ploom's contractual relationship with JTI – one of Japan's largest tobacco companies[113] – could determine an investor's outlook on Ploom's value. For example, Dickman explained that, if JTI has a contractual right to acquire Ploom, or if JTI contractually were slated to stop paying royalties to Ploom, the terms of Ploom's agreements with JTI could affect an investor's perceived value of Ploom and its business.[114] On the other hand, for at least three reasons, Ploom urges this Court not to compel it to make this information available for Quantum's inspection. First, Ploom contends that the nature and value of its relationship with JTI sufficiently is reflected in Ploom's historical and projected financial information. Second, Ploom reasons inspection should not be ordered in view of Ploom's contractual obligation to JTI not to

[113] Quantum's Pre-Trial Br. 3.
[114] Tr. 38–39. *See also* Quantum's Pre-Trial Br. 30 (quoting Dickman Dep. 170).

divulge it. Finally, Ploom argues that disclosure of the terms of the JTI agreements, whether inadvertently or by a mischievous third party, would be disastrous for Ploom.

I find Ploom's position more persuasive. In *Neely v. Oklahoma Publishing Co.*,[115] this Court was presented with a similarly probing stockholder request, and observed:

> If the standard is limited to that which is sufficient and essential, then obviously it stops short of including all books and records of a corporation … or, stated another way, it stops short of all books and records which the petitioning stockholder, in his or her personal opinion, deems to be essential. The one thing that the opposing experts [who testified in this case] agreed upon is that there is no such thing as a precise market value of stock in a company whose stock is not publicly traded. Even so, to attempt to reach the ultimate of near-precision, it can be assumed that one can never get enough information unless he is given access to everything. When this is measured against plaintiff's position that she would like to sell if the right deal comes along even though she has nothing definite in mind now, her demand becomes one to be advised of all internal affairs of the corporation and to be kept current on a monthly basis hereafter just in case. To honor the extent of her demand under these circumstances would virtually transform her into an ex officio member of the board of directors simply because she has decided to rid herself of her stock.[116]

Here, although Quantum credibly has articulated that confirmation of certain aspects of Ploom's contractual relationship with JTI would be helpful, it has not demonstrated that such information is essential. For example, Dickman expressed a desire for information concerning whether JTI is contractually permitted to reduce its royalty payments to Ploom upon certain specified events. Information of that nature should, at least implicitly, be baked into the forecasts and projections requested in

[115] 1977 WL 2563 (Del. Ch. Aug. 15, 1977).
[116] *Id.* at *3.

category 6. In addition, the value of the JTI relationship reasonably should be reflected in the other documents that Quantum is entitled to inspect pursuant to this action. Although this result limits Quantum's ability to collect every morsel of probative information concerning Ploom's prospects, the incremental value of this information to Quantum's purpose is outweighed both by Ploom's contractual obligation to maintain its confidentiality and by the relative harm associated with an unintended leak or a misuse of the information in issue.

I therefore recommend that the Court deny Quantum's Demand as to category 9. I also recommend, however, that the Court do so without prejudice, such that Quantum may make a new demand if it can demonstrate that potential purchasers are refusing to proceed without access to such contracts, or some other concrete need that outweighs the Company's strong interest in protecting the information from disclosure.

9. Time Periods Governing Inspection

Finally, the parties disagree about the time period that should govern the scope of Quantum's inspection. Although the Demand seeks books and records as of the date of the Demand, imposing such a time limitation would be both inequitable and self-defeating given the passage of time. Ploom's delay and its decision to force a trial in this matter have rendered that date stale. Having concluded that Quantum has stated a proper purpose in seeking to value and market its shares, the Supreme Court's decision in *Carroll* instructs that the information provided must be current to achieve that purpose.[117]

[117] *CM & M Gp., Inc. v. Carroll*, 453 A.2d 788, 794 (Del. 1982).

As to documents associated with categories 2, 3, and 4, I find that Quantum has demonstrated its need for documents covering the previous three fiscal years. As to categories 2 and 4, Quantum is entitled to inspect the relevant documents from 2011, 2012, and 2013. As to the documents demanded in category 3, Quantum is entitled to inspect Ploom's quarterly financial statements, to the extent they exist, "for all periods subsequent to the last financial statement produced in response to [category 2]."

As to categories 5, 6, 7, and 8, Quantum is entitled to inspect such documents with a beginning date of January 1, 2012, rather than January 1, 2011. Dickman acknowledged that Ploom's business and finances are volatile and rapidly changing. In light of that volatility, and the fluid nature of financial information generally, Quantum has not demonstrated that the information embedded in valuations, forecasts, or stock purchase offers or transaction documents reaching back to 2011 are essential to calculating Ploom's current value.

Finally, in keeping with the Supreme Court's decision in *Carroll*, and in view of the difficulties in selling stock in an early stage, close corporation, I recommend that the Court retain jurisdiction over this action for one year to allow Quantum to present not more than two petitions to inspect and copy necessary books and records for updated information to facilitate the valuation and sale of its stock.[118]

[118] *CM & M Gp., Inc. v. Carroll*, 453 A.2d 788, 794 (Del. 1982). I note, however, that if Quantum later seeks to inspect information that is not within the categories of information sought in this action, Quantum would need to make a new demand and, if necessary, file a new action.

F. The Confidentiality Agreement

The parties' mutual failure to discuss in good faith (or, more accurately, at all)[119] the appropriate parameters of a confidentiality agreement leaves this Court with the unwelcome task of finding an appropriate middle ground between the at-times extreme positions taken by both sides. Unsurprisingly, each side proposed a confidentiality agreement with terms highly favorable to its interests. Ploom's proposed confidentiality agreement[120] unduly restricts Quantum's ability to sell its shares, and in fact could make it nearly impossible for Quantum to achieve that objective. Quantum's proposed agreement,[121] on the other hand, at times fails to balance appropriately Quantum's interests with Ploom's legitimate and important need to safeguard its confidential and proprietary information. What follows is an attempt to resolve the parties' disputes, other than minor differences in wording that were not identified as material disputes in the parties' post-trial submissions. The parties are free to revise this language if both sides agree further changes are warranted or necessary.

1. The Definition of Competitor

The first dispute between the parties arises from their diverging definitions of the term "Competitor." Quantum's proposed definition defines Competitor as "a direct competitor of Ploom" who "develops, produces, or manufactures electronic cigarettes or handheld tobacco vaporizers," has demonstrated an intent to do the same, or publicly has

[119] To the extent it was unclear, my repeated use of the word "discussion" did not mean an e-mail exchange of competing versions of an agreement.
[120] Letter to the Court from David Teklits, Esq., Feb. 3, 2014, Ex. A (hereinafter "Ploom's Proposed Order").
[121] Letter to the Court from Steven C. Hough, Esq., Feb. 3, 2014, Ex. A (hereinafter "Quantum's Proposed Order").

disclosed that it holds 25% or more of the stock of such a company.[122] Ploom, on the other hand, defines a Competitor as a person Ploom identifies as "engaging, endeavoring, or may engage [sic] in the same or similar lines of business, provide the same or similar services, sell the same or similar competitive products, and/or operate in the same market or markets as Ploom," or any person who owns or is affiliated with a person who owns 5% or more of the stock of such a company.[123]

As will soon become a familiar refrain, neither proposal strikes an appropriate balance between the parties' interests. Instead, the confidentiality order should define "Competitor" as:

> Any Person whom Ploom identifies in good faith as a competitor who: (1) engages, or is endeavoring to engage, in the same or similar lines of business, provides the same or similar services, or sells the same, similar, or competitive products; (2) publicly has disclosed that it owns 5% or more of the outstanding capital stock (or other voting securities) of any such Person identified in Paragraph (1), or (3) is a(n) officer, manager, member, employee, director, or affiliate of any such Person identified in Paragraphs (1) or (2).

Although this definition is broader than that proposed by Quantum, it takes into account that Ploom's business is still developing and may include products or services other than those it currently manufactures or sells. In addition, Quantum's proposed 25% ownership limitation sets the ownership bar far too high. Contrary to Quantum's argument, a 5% ownership threshold is not "de minimus," and it is the percentage of ownership recognized by the SEC as the appropriate point where ownership in a public company must be disclosed. Moreover, because I do not adopt Ploom's unreasonable

[122] Quantum's Proposed Order ¶ 1(a).
[123] Ploom's Proposed Order ¶ 1(a).

restrictions on what constitutes "Highly Confidential" information and what information may be provided to a Competitor, as explained below, adopting a broader definition of Competitor should not unduly constrain Quantum's ability to market its shares.

2. The Definitions of Confidential Information and Highly Confidential Information

At the close of trial, I directed the parties to revise their proposed confidentiality agreements to identify with greater specificity the type of information that would qualify as Confidential and Highly Confidential. Quantum followed that direction and, predictably, identified nearly all the books and records it seeks to inspect as Confidential Information. Ploom, on the other hand, continues to define Confidential Information as any information that contains "non-public, confidential, proprietary or commercially sensitive information of Ploom," including its financial statements and its valuations, while defining Highly Confidential information in a similarly vague fashion.[124] Ploom's proposed definitions give the Company authority to designate information as Confidential or Highly Confidential, unconstrained by any precise guidelines. The specificity of Quantum's Proposed Order is more consistent with what I intended and what this Court ordered in *Schoon v. Troy*.[125] I believe the following balances the parties' interests more correctly:

[124] The use of the word "non-public" in the definition of Confidential Information, at least in this context and coupled with Ploom's proposed restrictions on Quantum's ability to share any confidential information with any person identified as a competitor, is so broad as to suggest a lack of good faith in Ploom's drafting efforts.

[125] *Schoon v. Troy Corp.*, C.A. No. 1677-N, Final Order (Del. Ch. Jul. 17, 2006), ¶¶ 1(f)-(j).

"Confidential Information" shall mean the following information received by Quantum from Ploom pursuant to this Order that is sensitive or proprietary to Ploom and is not generally available to the public:

(i) Ploom's capitalization table;
(ii) Ploom's annual and quarterly financial statements;
(iii) Ploom's federal and state income tax returns;
(iv) Formal and informal valuations of Ploom or its stock, provided that any information in such valuations that comprise forecasts shall be Highly Confidential Information;
(v) Contracts or agreements for any transaction involving Ploom's stock; and
(vi) Offers or proposals to buy or sell Ploom's stock.[126]

"Highly Confidential Information" shall mean the following information received by Quantum from Ploom pursuant to this Order that is highly sensitive or proprietary to Ploom and is not generally available to the public:

(i) Ploom's list of record stockholders;
(ii) Forecasts, whether formal or informal, for Ploom; and
(iii) Information related to product development, business plans, customer lists, supplier lists, product margin information, product formulas or designs, or similarly sensitive information.[127]

3. Restrictions on Quantum's Use of Confidential and Highly Confidential Information

The difficultly in adopting Ploom's amorphous and broad definitions of "Confidential Information" and "Highly Confidential Information" is compounded by

[126] Quantum's Proposed Order included in the definition of "Confidential Information" the "transaction documents, as amended, memorializing Quantum's investment in Ploom." These documents were not requested in the Demand, however, and because the definition of Confidential Information is limited to documents produced pursuant to the Court's Order, I do not include these transaction documents in the definition of Confidential Information.

[127] The information listed in subparagraph (iii) is not requested in Quantum's Demand, but conceivably may be contained within some of the records Quantum seeks to inspect, particularly any valuations. I therefore include this language out of an abundance of caution. I exclude from the definitions of "Confidential Information" and "Highly Confidential Information" references to the contracts or agreements between Ploom and JTI because I recommend that the Court deny inspection of those agreements. If the Court does not follow that recommendation, however, all information related to Ploom's agreements with JTI appropriately is classified as "Highly Confidential Information."

Ploom's proposed limitations on Quantum's ability to share such information with any potential purchaser who Ploom identifies as a Competitor. Under Ploom's Proposed Order, Quantum can provide "Confidential Information" only to a Competitor's third party financial advisor, and cannot provide "Highly Confidential Information" to anyone, even non-competitors.[128] Quantum's Proposed Order, on the other hand, would allow Quantum to provide Confidential Information to any person, without advanced notice to Ploom, and to provide Highly Confidential Information to a potential purchaser not identified as a Competitor, or to a Competitor's financial advisor.[129]

Quantum's proposal more closely approaches a fair balance between the parties' interests, but some changes are warranted. As an initial matter, the parties agree that no information may be provided to a potential purchaser before the potential purchaser executes a third-party confidentiality agreement (the "Third-Party Agreement") in the form appended to each party's respective confidentiality agreement. In addition, the confidentiality agreement should specify that Quantum must provide advance notice to Ploom five business days before Quantum provides any Confidential Information or Highly Confidential Information to a potential purchaser. If Ploom identifies the potential purchaser as a Competitor during the five business day notice period, Ploom may provide Confidential Information to the Competitor, but only if the Competitor executes an addendum to the Third-Party Agreement, which provides that the Confidential Information shall not be reviewed by any officer, manager, member,

[128] Ploom's Proposed Order ¶¶ 7-8.
[129] Quantum's Proposed Order ¶¶ 6-9.

employee, or director of the Competitor who is directly engaged in a business that competes with Ploom. The confidentiality agreement also should specify that Quantum may not provide any Highly Confidential Information to any potential purchaser, except that forecasts may be provided to a potential purchaser who Ploom does not identify as a Competitor, or to a Competitor's third-party financial advisor, provided the financial advisor executes the addendum that appears at Exhibit C to Quantum's Proposed Order and provided that Quantum gives notice to Ploom five business days before the information is provided to any financial advisor.

4. Restrictions on Financial Advisors

Ploom's Proposed Order would limit the financial advisors who may receive Ploom's information to an advisor who is "located in the United States, and a registered broker-dealer or registered investment advisor with the SEC."[130] Ploom explains that this restriction provides it with assurance that the financial advisor is reputable and can be trusted to protect Ploom's information and respect the terms of the Third-Party Agreement and addendum. This restriction is unduly burdensome for two reasons. First, the testimony at trial established that many of the companies or individuals who may be interested in purchasing Quantum's shares are located outside the United States.[131] It follows that these potential buyers may wish to retain financial advisors who are not located in the United States or registered with the SEC. Second, Ploom's interests are protected by the addendum to the Third Party Agreement, under which the financial

[130] Ploom's Proposed Order ¶ 5 & Ex. C. ¶ 1.
[131] Tr. 48-50 (Dickman).

advisor submits to the jurisdiction of this Court. If Ploom has genuine and concrete concerns about a particular financial advisor, the advance notice provision will allow Ploom to seek an order from this Court barring disclosure of Ploom's information to that advisor.

5. The Burden to Justify Confidentiality Designations

Quantum's Proposed Order places on Ploom the burden of justifying its designations of a Potential Purchaser as a Competitor or of information as Confidential or Highly Confidential. Predictably, Ploom's Proposed Order struck this language. I find that Quantum's proposal is consistent with the general rule in Delaware that a party seeking confidential treatment bears the burden of demonstrating the need for such treatment.[132] Likewise, it is reasonable to expect Ploom to justify its designation of a potential purchaser as a Competitor, because Ploom is in the best position to understand and explain its business and the competitive threats it faces.

6. The Production of Books and Records

It is more than disappointing that the parties could not even agree on a timeframe for production of the books and records Ploom must produce for inspection. Quantum argues that five business days are sufficient, while Ploom proposes a ten business day time frame. Reasonable minds might have, for example, suggested the parties meet in the middle. The parties instead wasted time and money briefing a difference of five business days. Paragraph 2 of the confidentiality order should state: "[w]ithin eight business days

[132] *See* Ch. Ct. R. 5.1(b)(3); *Romero v. Dowdell*, 2006 WL 1229090, at *1 & n. 6 (Del. Ch. Apr. 28, 2006).

following the entry of this Order, Ploom shall produce or make available to Quantum books and records as ordered by the Court of Chancery." That paragraph also should require information that is current as of the date of the Court's order, and should, as set forth in Section II.E.9, provide Quantum with a right to make two requests for updated information within a year of entry of the confidentiality order.

7. Liability for Unauthorized Use or Disclosure

The parties also dispute the degree to which liability may be imposed on Quantum if persons who receive Ploom's information violate the terms of the confidentiality order or the Third-Party Agreement. Ploom suggests language that would require Quantum to "ensure that each recipient of Confidential Information protects the Confidential Information so that it is not disclosed," and provides that "Quantum shall be liable to [Ploom] and responsible for any breach of the terms of this Order by any Person to whom [Quantum] has provided information."[133] This proposal extends too far and could significantly chill Quantum's ability to market its shares. Although the confidentiality order entered by this Court in *Schoon v. Troy Corp.* contained language requiring the inspecting stockholders to ensure that information was protected with "a reasonable standard of care," that limitation appeared only to apply to the stockholders' employees, counsel, financial advisors, outside auditors, and other agents.[134] It is not clear how Quantum could "ensure" that a potential purchaser complies with its obligations under

[133] Ploom's Proposed Order ¶¶ 5, 13.
[134] *Schoon v. Troy Corp.*, C.A. No. 1677-N, Final Order (Del. Ch. Jul. 17, 2006) ¶ 7.

the Third-Party Agreement, and to require Quantum to undertake such an obligation and face liability in connection with it is not a reasonable restriction on Quantum.

Here, Quantum's suggested language is more reasonable than is Ploom's. I therefore recommend that the confidentiality order and the Third-Party Agreement require a recipient of books and records – whether Quantum or a Potential Purchaser – to "protect the Confidential and Highly Confidential Information with at least the same degree of care and confidentiality that they use for their own information that they do not wish to disclose, but in no event less than a reasonable standard of care." That restriction, in addition to the parties' agreed upon language naming Ploom as a third-party beneficiary of the Third-Party Agreement and specifying that specific performance and injunctive relief are available to remedy violations of the order, is sufficient to protect Ploom's interests in ensuring compliance with the confidentiality order.

8. Subpoenas

Further reflecting the parties' utter failure to meet and confer regarding the differences between their respective confidentiality agreements, Quantum identified differences in subpoena procedures as one of the parties' material disagreements, while Ploom failed to address that difference in either of its post-trial letter submissions regarding the terms of the confidentiality order. I therefore find that Ploom has waived any objections it may have had to Quantum's proposed language.

9. Termination of Rights and Destruction of Books and Records

Ploom's Proposed Order also would place a time limit on Quantum's ability to use the books and records to sell its shares and on a potential purchaser's time to hold

information before destroying it, by requiring a potential purchaser to destroy information within two months of receipt and by requiring Quantum to destroy all books and records within nine months of receipt. Ploom argues these restrictions are necessary to protect its information from inadvertent disclosure and should provide Quantum with "more than sufficient" time to sell its shares. Ploom offers no precedent for these proposed restrictions, nor do the restrictions appear reasonable in light of (1) the limited market for Ploom's shares, as supported by testimony at trial, suggesting that it may take more than nine months for Quantum to sell its stock, and (2) the fact that a passing familiarity with deal work and private sales of stock supports a conclusion that such sales often take longer than two months to negotiate and complete. Such a restriction also invites further books and records demands from Quantum, which history shows Ploom may resist, further extending the time before Quantum can exit its investment. Accordingly, I recommend that the Court exclude any such time limitation from the confidentiality order.

10. Expiration of Confidentiality Designations

For its part, Quantum proposes that all of Ploom's confidentiality designations will expire five years after the information is disclosed. Ploom protests this restriction as arbitrary and unnecessary in light of the provision in the confidentiality order allowing Quantum to use information free of restrictions if the information is independently obtained or publicly available. Quantum's proposed sunset provision, however, is consistent with – and in some cases more generous than – similar orders entered by this

Court.[135] Ploom cannot reasonably dispute that, after five years, the information at issue likely will be so stale that its competitive value will be non-existent. Nonetheless, to prevent any possible harm to Ploom by this sunset provision, the confidentiality order should provide that Ploom may seek continued confidential treatment of specified highly confidential information – no less than six months before such treatment otherwise would expire – by filing a motion with the Court for relief from this paragraph of the confidentiality order.

11. Information Generally Available or Independently Acquired

Both parties agree that Quantum may use information free from restriction, including information designated as Confidential or Highly Confidential, if the information becomes generally available to the public or was independently acquired without violating any obligation under the confidentiality order. The parties dispute, however, who should bear the burden of establishing that information falls within this category, with each side contending that if it is required to bear the burden it will be forced to "prove a negative."

I find that it would be unreasonable to allow Quantum to declare its belief that information has become publicly available or independently was obtained, and then shift to Ploom the burden to prove a negative. Accordingly, the confidentiality order should

[135] *See, e.g., Ad-Venture Cap. Partners, L.P. v. ISN Software Corp.*, C.A. No. 6618-VCG, at 6-7 (Del. Ch. Mar. 5, 2012) (TRANSCRIPT) ("[I]t seems to me that it is likely that whatever the competitive value of the documents that I have ordered disclosed is that it will be so significantly reduced over a two-year period that that's the appropriate length of time."); *Schoon v. Troy Corp.*, C.A. No. 1677-N, Final Order (Del. Ch. Jul. 17, 2006) ¶ 14 ("All confidentiality obligations shall lapse with respect to Information five years after such information is disclosed pursuant to the terms of this Order.").

require Quantum to prove that information is publicly available or independently obtained, but if Ploom contends the information was obtained in violation of the confidentiality order, it should be required to bear that burden. Once again, this conclusion is neither novel nor difficult, and the parties likely could have gotten there themselves had they engaged in good faith discussions.

12. Fee-Shifting

The parties' final dispute regarding the confidentiality order involves fee-shifting in actions relating to the confidentiality order. The parties agree that the prevailing party is entitled to have its fees and costs paid by the non-prevailing party, but disagree about what types of actions qualify for fee-shifting. Ploom proposes that fee-shifting will be appropriate only "in the event of a lawsuit to enforce" the confidentiality order, while Quantum maintains fee-shifting should occur "in any action or lawsuit to enforce or interpret any provision" of the confidentiality order. I recommend that the Court adopt Quantum's language, which places the parties on more equal footing, because actions to "enforce" the order are more likely to be initiated by Ploom, rather than Quantum.

Conclusion

For the foregoing reasons, I recommend that the Court order Ploom to produce its books and records for inspection, consistent with the parameters identified in this report and subject to Quantum executing a confidentiality agreement containing the terms outlined above. This is my final report and exceptions may be taken in accordance with Court of Chancery Rule 144.

/s/ *Abigail M. LeGrow*
Master in Chancery