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

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| RICHARD SCHOON and STEEL INVESTMENT COMPANY, a Delaware corporation, | ) | |
| Plaintiffs, | ) | |
| v. | ) | C.A. No. 1677-N |
| TROY CORPORATION, a Delaware corporation, | ) | |
| Defendant. | ) | |

***MEMORANDUM OPINION AND ORDER***

**Submitted: June 8, 2006**
**Decided: June 27, 2006**

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LAMB, Vice Chancellor.

In this books and records case, the issues remaining to be decided following trial relate primarily to the terms of the parties' competing proposed confidentiality agreements. The stockholder plaintiff plans to make use of the defendant company's books and records to seek a buyer for its shares. The company, naturally, is concerned that the disclosure of its confidential financial and operating information to its principal competitors–who are among the most likely potential buyers of those shares–would cause substantial injury to its business. As required by Section 220 of the Delaware General Corporation Law, the court attempts to resolve the parties' conflicted positions in a way that balances the stockholder's right to find a buyer for its shares with the company's legitimate interest in protecting its competitive position and advantages.

**I.**

Defendant Troy Corporation is a privately held Delaware corporation which develops speciality chemicals. The plaintiffs, Richard Schoon, a director of Troy, and Steel Investment Company, a 33% stockholder of Troy, seek to compel the inspection of the corporate books and records of Troy pursuant to 8 *Del. C.* § 220. Steel is a privately held Delaware corporation used by the members of the Bohnen family as a holding company for various investments.[1] On June 20, 1980,

[1] Pretrial Stipulation and Order ("PTO") 11, 12. The directors of Steel are brothers James Bohnen, William Bohnen, and Steven Bohnen, and their sisters, Anne Mommsen and Gail Cummings, and Gail's husband James Cummings.

Steel purchased 95% of Troy's Series B common stock, constituting approximately 33% of Troy's equity, pursuant to a stock purchase agreement.[2] As the holder of Troy's Series B stock, Steel is entitled to elect one director to the Troy board. Schoon is the Series B director elected by Steel.[3]

In August 2005, Schoon requested that Troy provide him with certain documents and updates "to fulfill his fiduciary duties as a director of Troy."[4] Troy offered to produce all of the records demanded if Schoon performed the inspection of the books and records at Troy's headquarters and signed a confidentiality agreement that prohibited him from sharing information with Steel. Schoon objected to these conditions and filed this action. At trial, Troy argued that Schoon's Section 220 request was not made in good faith to fulfill his fiduciary duties as a director of Troy, but rather was based on an improper purpose. Troy claimed that Steel wanted to liquidate its shares in Troy and asked Schoon in confidence to provide it with corporate information so that it could value its shares and sell its stock to third parties, including Troy competitors. Therefore, Troy

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[2] JX 2; PTO 13, 14. The issued and outstanding shares of Series B common stock not held by Steel are held directly by members of the Bohnen family.
[3] PTO 6, 19; JX 90. Schoon serves as a financial consultant to Steel and the Bohnen family. In February 2005, the Bohnen family elected Schoon by written consent as the Series B director. The Troy board consists of five directors: Daryl Smith, Mark Gwillim, John Beckert, Conrad Plimpton, and Schoon.
[4] JX 132.

argued, Schoon's demand was made at the behest of Steel and was adverse to Troy's interests.

The court addressed and disposed of this aspect of the case at the June 8, 2006 post-trial argument. To summarize, the court found that Troy established at trial[5] that Schoon's request for inspection of the company's books and records was not for a proper purpose reasonably related to his position as a director.[6] Rather, Schoon's request for inspection of Troy's books and records was made in consultation with and at the direction of Steel to obtain information for Steel so that it could sell its equity stake in Troy. Most telling, Steel authorized and approved a commission to Schoon of up to $500,000 if Schoon was able to sell Steel's shares in Troy by December 2005.[7] Therefore, it is clear that Schoon's request for inspection of Troy's books and records was made when he had a financial incentive to assist Steel in selling its shares at the highest price attainable. Due to this undisclosed conflict of interest, the court cannot find that Schoon's

[5] Trial was held April 8, 2006.
[6] 8 *Del. C.* § 220(d) provides that "any director . . . shall have the right to examine the corporation's stock ledger, a list of its stockholders and its other books and records for a purpose reasonably related to the director's position as a director." *See Henshaw v. American Cement Corp.*, 252 A.2d 125, 130 n.3 (Del. Ch. 1969) (holding that it is within the discretion of the Court of Chancery to condition or limit the right of inspection if necessary to protect the corporation).
[7] JX 16.

request was made for a purpose related to his directorial duties, and therefore did not grant any relief to Schoon.[8]

Also in August 2005, Steel demanded inspection of Troy's books and records, pursuant to Section 220, to value its shares and facilitate the sale of its stock to a third party. Troy did not dispute the scope of the inspection and agreed to provide Steel with all of the categories of information it requested if Steel executed a confidentiality agreement that severely restricted its ability to share information with third parties.[9]

Troy argues that this confidentiality agreement is necessary because the parties agreed in connection with Steel's 1980 purchase of Troy's shares that Steel may not share Troy's documents, including financial statements, with third parties without Troy's consent. In effect, Troy contends that this agreement, entered into over 25 years ago, now governs Steel's inspection rights pursuant to Section 220. Furthermore, Troy claims that Steel has been improperly disclosing Troy's confidential corporate information to Troy's competitors, namely International Speciality Products, Inc. ("ISP"), Rohm & Haas Co. ("R&H"), and Arch

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[8] *See Milstein v. DEC Ins. Brokerage Corp.*, Del. Ch., C.A. Nos. 17586 and 17587, Lamb, V.C., Bench Ruling Tr. at 3 (Feb. 1, 2000) (expressing the "view that the right of a director of a Delaware corporation to inspect, have access to the books and records of the corporation, is quite broad. It has been described by me, and I think others, as essentially unfettered in nature . . . but . . . is limited in the sense that . . . the request for information must be for a purpose that is . . . reasonably related to the director's position as a director").

[9] JX 131.

Chemicals, Inc. ("Arch"). At post-trial argument, the court explained its determination that Troy's contentions lacked merit and that its confidentiality agreement was unreasonable. Briefly, the reasons are as follows.

First, the court rejected Troy's argument that Steel's Section 220 rights are defined by the parties' 1980 stock purchase agreement. The agreement provided Steel with a broad right to access Troy's books and records, including financial statements, so that Steel could monitor its investment in Troy on an on-going basis.[10] The agreement did not in any way, explicitly or implicitly, contractually limit the information that must be provided to Steel in the exercise of its statutorily protected inspection rights under Section 220. "There can be no waiver of a statutory right unless that waiver is clearly and affirmatively expressed in the relevant document."[11] Accordingly, Troy cannot interpose its 1980 stock purchase agreement to abridge Steel's Section 220 investigatory rights.[12]

Second, the court concludes that the evidence at trial supports a finding that Steel has a proper purpose to inspect the corporate books and records of Troy,

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[10] JX 2 § 9.1.

[11] *Kortum v. Webasto Sunroofs, Inc.*, 769 A.2d 113, 125 (Del. Ch. 2000) (rejecting the idea that the shareholder is only entitled to documents provided for in the shareholders agreement because the "shareholders agreement does not contractually limit the information that must be provided to [the] shareholders, nor does it expressly provide for a waiver of statutory inspection rights under § 220.").

[12] *BBC Acquisition Corp. v. Durr-Fillauer Medical Inc.*, 623 A.2d 85, 90 (Del. Ch. 1992) (holding that an agreement cannot abridge a stockholder's entitlement under § 220).

*i.e.*, to value its shares and to negotiate the sale of its stock to a third party.[13] It is well established that valuing one's shares in the corporation in order to facilitate a sale of one's stock is a proper purpose under Section 220.[14] Furthermore, the court found that Troy did not establish at trial that Steel had improperly shared Troy's confidential or proprietary information to third-party competitors ISP, R&H, or Arch.[15] Accordingly, as the court ruled at oral argument, Steel is entitled to inspect

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[13] Tr. 20-46. The inspection rights of a stockholder are governed by 8 *Del. C.* § 220(c), which pertinently provides that "where the stockholder seeks to inspect the corporation's books and records, other than its stock ledger or list of stockholders, such stockholder shall first establish (1) that such stockholder has complied with this section regarding the form and manner of making demand for inspection of such documents; and (2) that the inspection such stockholder seeks is for a proper purpose."

[14] *See CM & M Group, Inc. v. Carroll*, 453 A.2d 788, 793 (Del. 1982) (holding that the valuation of one's shares in order to negotiate a fair sale of his stock is a proper purpose for the inspection of corporate books and records under § 220)*; BBC Acquisition Corp.*, 623 A.2d at 90 (holding that the company's defense that inspection relief should be denied because the plaintiff is a business competitor, without more, does not defeat the statutory right of inspection); *see also Macklowe v. Planet Hollywood, Inc.*, 1994 Del. Ch. LEXIS 182 at * 14 (Del. Ch. Sept. 29, 1994) (holding that "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 this is by examining the appropriate corporate books and records"); *Helmsman Mgmt. Servs., Inc. v. A&S Consultants, Inc.*, 525 A.2d 160, 164 (Del. Ch. 1987).

[15] Troy's improper information-sharing defense was primarily based on the theory that Steel directed Plimpton, a Troy director, to contact Troy's competitors and share with them Troy's most sensitive financial information, as well as other proprietary and confidential information, to illicit interest in purchasing Troy shares. In fact, Plimpton and his e-mail correspondence with Troy competitors (of which Steel was copied) provided the only support for Troy's contention that Steel improperly shared confidential information with Troy competitors ISP, R&H, and Arch. Thus, Plimpton's testimony was essential to Troy's defense. However, at the pre-trial conference, Troy informed the court that Plimpton was not available to attend trial because he was scheduled to be on an overseas vacation. The court ordered Plimpton to appear at trial, and informed Troy that, to the extent it chose not to produce Plimpton at trial, Troy was precluded from relying on Plimpton's deposition testimony (which was replete with inconsistencies and incredible statements) as a substitute for his appearance at trial. At trial, without Plimpton's testimony, Troy did not establish that Steel was in any way responsible for Plimpton's improper conduct. Indeed, both Schoon and Bohnen testified credibly that they did not share Troy's confidential information with Troy competitors and did not encourage or instruct Plimpton to share Troy's confidential information with third parties. Tr. 26, 30, 44-45, 113, 117-18, 126-31, 177-78.

the books and records of Troy and share the information it obtains with bona fide prospective purchasers pursuant to a reasonable confidentiality order.

The court is cognizant of Troy's legitimate concern that it will be harmed if its competitors are permitted access to its proprietary and confidential business information. Therefore, in determining the proper inspection relief, the court must balance the stockholder's statutory right to inspect the corporation's books and records with the corporation's legitimate interest to safeguard its highly confidential information from its competitors.[16] With this problem in mind, the court will now turn to the parties' competing proposed confidentiality orders and prescribe the necessary limitations and conditions.[17]

**II.**

At the close of trial, the court asked Troy and Steel to submit a proposed confidentiality agreement that includes reasonable restrictions on Steel's ability to disclose information to bona fide third-party prospective purchasers of its Troy

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[16] See *CM & M Group*, 453 A.2d at 793-94 ("The Court of Chancery is empowered to protect the corporation's legitimate interests and to prevent possible abuse of the shareholder's right of inspection by placing such reasonable restrictions and limitations as it deems proper on the exercise of the right."); *Disney v. The Walt Disney Co.*, 857 A.2d 444, 447 (Del. Ch. 2004) (holding that counterposed to the duty to protect the rights of the stockholder, the court has the duty to safeguard the rights and legitimate interests of the corporation); *see also Kortum*, 769 A.2d at 124 (holding that a stockholder's status as a competitor may limit the scope of, or require imposing conditions upon, inspection relief, but that status does not defeat the stockholder's legal entitlement to relief).

[17] 8 *Del. C.* § 220(c)(3) states that "the Court may, in its discretion, prescribe any limitations or conditions with reference to the inspection, or award such other or further relief as the Court may deem just and proper."

shares. The court received competing proposed forms of order that had major structural differences. Both parties proposed in their confidentiality agreements three classes of potential recipients (Non-Competitors, Level One Competitors, and Level Two Competitors) of the information requested in Steel's demand subject to a third-party confidentiality agreement. However, the parties define the last two classes differently.[18] Steel distinguishes between the Level One and Level Two Competitors based on whether they compete with Troy in a market in which more or less than 33% of Troy's annual revenues are generated. Troy takes a different approach and defines the Level One and Level Two Competitors as those whom Troy identifies in good faith as competitors of Troy based on their particular products and whether they have in the past infringed on Troy's intellectual property rights. Troy specifically names ISP, Arch, and R&H as Level Two Competitors.

The parties' confidentiality agreements then specify, based on the designated level of the competitor, which representatives of that competitor may receive the information and place restrictions on what information those representatives may receive and disclose to others representing the competitor. Both parties agree, in part, that a Non-Competitor may directly receive confidential information, a Level One Competitor may not disclose sensitive information with its operating

[18] *Compare* Def. Letter Br. ("DLB") Ex. B, § 1.b, c with Pl. Letter Br. ("PLB") Ex. A, § 1.b, c.

management working in the business that competes with Troy, and a Level Two Competitor may not receive sensitive information directly, but must retain an independent financial advisor to receive and review that information. However, the parties disagree over what information a Non-Competitor, Level One Competitor's representative, and Level Two Competitor's financial advisor may receive.

Troy's confidentiality agreement specifies 17 classes of Troy documents that Steel can share with third parties or their representatives, and provides that Steel can obtain and share information beyond these 17 classes of documents provided that it complies with the terms of the 1980 agreement, i.e., that it first obtain Troy's consent. Troy's confidentiality agreement also provides that a Non-Competitor and a Level One Competitor's representative may receive all of the 17 categories of information if Steel delivers to Troy a third-party confidentiality agreement.

Troy proposes that Steel may disclose the information only to an independent financial advisor of a Level Two Competitor pursuant to a confidentiality agreement, but not to a Level Two Competitor directly. A Level Two Competitor's financial advisor may then only prepare a report for the Level Two Competitor advising it on whether it should purchase Steel's equity interest in Troy. The report "may not contain any specific information or any other information (which includes, without limitation, valuation methodologies,

assumptions or principles) from which the information, or any item thereof, may be reasonably discerned by the Level Two Competitor but may contain valuations of Steel's minority equity interest in Troy based upon the information."[19]

Steel's confidentiality agreement proposes four classes of confidential information, and, depending on the level of the information and the type of information, it imposes different restrictions on Steel's disclosure to the third party or its representative. The four classes of information are:

1. Basic Information: (i) Troy's audited financial statements, including footnotes, for the three fiscal years most recently available, (ii) quarterly unaudited statements since the date of the most recently available annual audited financial statements, (iii) a list identifying Troy's operating subsidiaries by name and jurisdiction of incorporation, (iv) Troy's certificate of incorporation and bylaws and the 1980 agreement, and (v) a list identifying each Troy director and each Troy stockholder by name, specifying the number and class or series of Troy shares owned, and providing the total number of shares outstanding in each class.

2. Securities Law Information: (i) information that Troy would be required to disclose under the federal securities laws if Troy were a publicly traded corporation listed on a national exchange or (ii) which falls within the 15 categories of information listed in *CM&M Group, Inc. v. Carroll*.

3. Additional Information: information about Troy beyond what Troy would be required to disclose under the federal securities laws if Troy were a publicly traded corporation listed on a national exchange.

[19]DLB Ex. B, § 4.c.

4. Highly Confidential Information: customer lists, supplier lists, margin information on a product-by-product basis, product formulas, or similarly sensitive information.

Steel's confidentiality agreement provides that Steel may disclose basic information to all third-party prospective purchasers if such parties execute confidentiality agreements. It states that, within 10 days *after* providing the basic information to a third party, Steel will provide Troy with written notice. For information other than basic information, Steel's confidentiality agreement outlines specific procedures to be followed depending on the level of the competitor. For example, for a Level Two Competitor, Steel may disclose securities information if the Level Two Competitor executes a confidentiality agreement, and Steel may provide the Level Two Competitor with additional information only if the Level Two Competitor executes an addendum to the confidentiality agreement which provides that the additional information shall be received only by an independent financial advisor of the Level Two Competitor. However, Steel may not, under any circumstances, disclose highly confidential information to a Level Two Competitor or any of its representatives.

**III.**

Troy's confidentiality agreement improperly provides that the 1980 agreement will govern Steel's right to obtain and disclose additional information. As explained above, the court rejects the notion that the 1980 agreement will

govern the terms of the confidentiality agreement. In addition, Troy's confidentiality agreement only identifies specific financial statements rather than referring to the most recently completed years of audited financial statements as information that can be provided to a potential purchaser.[20] A potential purchaser is entitled to inspect Troy's most current financial statements to value Steel's shares.[21]

Moreover, Troy's absolute restriction on the ability of a Level Two Competitor's financial advisor to disclose any information to the Level Two Competitor is unreasonable. Effectively, Troy's confidentiality agreement precludes the financial advisor from disclosing Troy's audited financial statements or any data derived therefrom, or any quantitative analysis of the valuation of Steel's stock, to a Level Two Competitor. Such absolute restrictions on the disclosure of a company's basic financial information is both excessive and unsupported by Delaware law.[22]

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[20] Troy's confidentiality agreement specifically identifies Troy's 2003, 2004, and 2005 consolidated audited financial statements and Troy's quarterly unaudited, internally prepared, consolidated financial statements from the date of the 2005 consolidated audited financial statements to March 31, 2006. Troy's proposal will be out of date in two months at the conclusion of Troy's 2006 fiscal year on June 30.

[21] *CM & M Group*, 453 A.2d at 794 (holding that "Section 220(c) clearly empowers the Court of Chancery, in the exercise of its discretion, to order the inspection of corporate books and records to ensure that the information required by the shareholder remains current").

[22] *Id.*

Finally, Troy's confidentiality agreement includes an unreasonable $5 million liquidated damage provision that would have the effect of chilling the sale process altogether. It is unreasonable to expect a bona fide purchaser or a financial advisor to agree to a confidentiality agreement that could possibly subject it to sanctions and $5 million in liquidated damages. The threat of a damage claim resulting from a breach of the confidentiality order is a sufficient deterrent to the improper use of Troy's information.

For these reasons, the court rejects Troy's proposal and starts with the framework of Steel's confidentiality agreement, but adopts several changes to protect Troy's legitimate interest of safeguarding its highly sensitive information.

Troy demonstrated at trial that, in particular, ISP, Arch, and R&H are high level competitors of Troy. Revenue measures cannot fully take into account the potential damage to Troy if confidential information about its products is released to third parties who are capable of copying or infringing upon Troy's product lines.[23] Therefore, the court concludes that Troy's specifically defined categories of competitors based on the particular product line of the competitor better address

[23] Revenue measures ignore, among other things, the degree of overlap in products and markets, the critical importance of certain products of Troy relative to other products, the capabilities of the competitor in terms of financial strength, pricing, power, market presence, and marketing capacity, and the past improper behaviors of the competitors such as patent infringement, all of which are indicative of the potential damage and future threats to Troy.

Troy's legitimate interest in preventing the disclosure of highly sensitive information.[24]

Troy shall have the opportunity in the first instance, in good faith, to determine whether a third party is a Non-Competitor, Level One Competitor, or a Level Two Competitor and to label the documents it discloses to Steel as (i) basic information, (ii) securities law information, (iii) additional information, or (iv) highly confidential information. In the event that Steel disputes Troy's designation of a third party or a document, Steel shall immediately notify Troy in writing, and the parties shall attempt to negotiate a resolution promptly and in good faith. If the dispute cannot be resolved within five business days after Troy receives Steel's written objection, the Court of Chancery retains jurisdiction to hear and determine such disputes or to refer them to a special master for prompt resolution.[25]

Steel shall have the power to disclose basic information to a Level Two Competitor pursuant to a confidentiality agreement which shall provide that no

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[24] The court does not agree with Steel that Troy's approach gives it unfettered discretion based on a subjective good faith test to determine who meets the definition of Level One and Level Two Competitors. The court finds that the categories are specifically and appropriately defined based on the particularized elements the competitor uses in its products. For example, a Level One Competitor is defined as "a manufacturer, producer or seller of preservatives and antimicrobials and additives for coatings and for other existing Troy end-use markets, including, but not limited to, metal carboxylates, metal-working fluid additives, plastics protection ingredients, powder coating additives, wood protection products and aftermarket additives for coatings." PLB Ex. A, § 1. c.

[25] The court agrees with Troy that Steel's arbitration dispute resolution provision would be overly burdensome to Troy.

financial statements contained therein will be disclosed to any officer or employee of the Level Two Competitor who is directly engaged in a business that competes with Troy. In addition, Steel may only disclose securities law information and additional information to the Level Two Competitor if the Level Two Competitor executes an addendum to the third-party confidentiality agreement providing that the securities law information and the additional information shall be reviewed only by a financial advisor for the Level Two Competitor and not by any director, officer, or employee of the Level Two Competitor. The financial advisor may rely upon such information in preparing a report valuing Steel's shares of Troy stock, but may disclose in that report only such information that it concludes, in good faith, is necessary and essential to the Level Two Competitor's ability to make use of its valuation analysis in offering to acquire Steel's shares of Troy stock. The financial advisor's report shall not be disclosed to or reviewed by any officer or employee of the Level Two Competitor who is directly engaged in a business that competes with Troy.

The court does not agree with Steel that there should be no advance notification requirement for the dissemination of basic Troy information, which includes its financial statements. Therefore, pursuant in part to Troy's advance notification provision, at least five business days prior to disclosing *any* of Troy's information to a third-party bona fide prospective purchaser or its representative,

Steel shall (1) notify Troy in writing that Steel intends to disclose the information to a third party, (2) certify in writing that the third party has made a written representation that it is a bona fide prospective purchaser of Steel's shares of Troy stock, (3) identify the name and address of such prospective purchaser and the competitor category in which the third party falls, (4) inform Troy in writing of the date that Steel will disclose the information to the prospective purchaser, and (5) provide Troy with the prospective purchaser's fully executed confidentiality agreement.[26]

## IV.

For the reasons set forth on the record at oral argument and in this opinion, the court finds that the stockholder plaintiff is entitled to the inspection of books and records of Troy Corporation pursuant to the terms set forth herein. The parties are directed to confer and submit within 10 days of the date hereof a form of order in conformity with this opinion. IT IS SO ORDERED.

[26] *CM & M Group*, 453 A.2d at 794 (requiring a five-day advance notification provision).