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Re: Robotti & Company, LLC v. Gulfport Energy Corporation
C.A. No. 1811-VCN
Date Submitted: April 24, 2007

Dear Counsel:

This letter opinion and order sets forth the Court's post-trial findings of fact and conclusions of law with respect to a demand for inspection of a corporation's books and records under 8 *Del. C.* § 220.

I. BACKGROUND

Plaintiff Robotti & Company, LLC ("Robotti") is a stockholder in Defendant Gulfport Energy Corporation ("Gulfport").¹ Gulfport announced a rights offering

¹ Trial Transcript ("Trial Tr.") at 9. Robotti's investment has a market value in excess of \$3 million.

(the “offering”) in a prospectus dated July 22, 2004; it offered a single transferable subscription right at a price of \$1.20 per share for every 1.0146 shares owned.² Gulfport’s shares were trading at \$3.10 on the “bulletin board,” a thinly traded and illiquid market.³ At the time of the offering, Robotti held approximately 90,000 shares.⁴ To the extent that the offering was undersubscribed, other shareholders could subscribe to any remaining shares if they fully exercised the initial subscription privilege.⁵ On November 17, 2005, Robotti made a demand upon Gulfport to inspect certain of its books and records pursuant to 8 *Del. C.* § 220; the primary motivation was to investigate the circumstances surrounding the offering.

Gulfport disclosed in its offering prospectus that the purpose of the offering was to fund “a portion of our currently proposed seismic and drilling programs.”⁶ At that time, Gulfport had only \$580,000 in cash available for investment.⁷ Gulfport was then engaged in a significant expansion of its drilling portfolio.⁸

² PX 2 at 14.

³ Trial Tr. at 11, 56. *See also* Pl.’s Post-Trial Opening Br. at 2. Robotti concedes that rights offerings are generally offered at a discount to market price, it argues that this discount was unusually low.

⁴ Trial Tr. at 9.

⁵ PX 2 at 15.

⁶ *Id.* at 3.

⁷ Trial Tr. at 87.

⁸ DX 22 at 16, DX 30, DX 46 at 16.

Gulfport's 10-Q for the quarter ended September 30, 2004, had disclosed that CD Holdings had applied toward its exercise of subscription rights a \$500,000 balance Gulfport owed under a prior credit facility, that \$11.1 million of net proceeds from the offering had been used to fund ongoing operations in the WCCB and East Hackberry oil fields, and that \$2.2 million of the proceeds would be applied to an outstanding balance with the Bank of Oklahoma.⁹

Gulfport had 2.4 million warrants and 627,000 options outstanding. The options were management-owned and an affiliate of Gulfport's controlling shareholder owned the majority of the warrants.¹⁰ The strike price for the warrants was \$4.00 and the strike price on the options was \$2.00.¹¹ Due to the low offering price for the subscription right, anti-dilution provisions protecting the holders of the warrants and options were triggered by the offering that gave them additional share rights to maintain their position after the offering, without their having to purchase additional shares in the offering. Thus, the shares distributed under the anti-dilution provisions raised no capital for Gulfport, but decreased the relative

⁹ DX 46 at 14, 22.

¹⁰ Trial Tr. at 14-17.

¹¹ *Id.* at 14.

value of shares for other shareholders. Robotti exercised its full subscription rights and additional subscription rights under the offering.

Gulfport also entered into a backstop agreement with CD Holdings, an affiliate of the controlling shareholder, with whom Gulfport also had a \$3 million line of credit. The backstop involved an up-front payment of \$240,000 to CD Holdings in exchange for CD Holdings' agreement to purchase any shares not sold in the offering. As all of the rights were sold in the offering, the backstop agreement was never invoked. Gulfport also had a revolving credit facility with CD Holdings. The second purpose listed for the offering in the prospectus was: "To the extent that CD Holding pays cash upon the exercise of its rights rather than reduces the outstanding obligations under its credit facility, we also intend to use a portion of the net proceeds to repay any remaining balance under that credit facility which we entered into on April 30, 2004."¹²

II. ANALYSIS

A. *Proper Purpose*

By 8 *Del. C.* § 220, a stockholder has the statutory right to inspect the books and records of the corporation. That right, however, is conditioned upon the

¹² PX 2 at 3-4.

stockholder's identification of a proper purpose for the inspection.¹³ A “proper purpose” is any purpose “reasonably related to such person's interest as a stockholder.”¹⁴ Robotti has advanced two purposes: valuation and investigation of wrongdoing.¹⁵

1. Valuation

One proper purpose for a books and records inspection is valuation of a stockholder's interest in the corporation.¹⁶ In this instance, as the scope of the demand is centered on events more than one year before the demand and almost two years before trial, the Court cannot find any relationship between the valuation purpose and the inspection demand. There is no new information within the scope of Robotti's various demands that could be of use in valuing its shares. To the extent that current valuation may be influenced by historical data, the information available in public filings is necessary and sufficient to meet the objective.¹⁷

¹³ See, e.g., *Highland Select Equity Fund, L.P. v. Motient Corp.*, 906 A.2d 156, 164 (Del. Ch. 2006), *aff'd*, 922 A.2d 415 (Del. 2007).

¹⁴ 8 Del. C. § 220(b).

¹⁵ The specific demands are set forth in Part III, *infra*.

¹⁶ *Schoon v. Troy Corp.*, 2006 WL 1851481, at *2 (Del. Ch. June 27, 2006), *rearg. denied*, 2006 WL 2162036 (Del. Ch. July 24, 2006).

¹⁷ *DPF, Inc. v. Interstate Brands Corp.*, 1975 WL 1963, at *2 (Del. Ch. Oct. 2, 1975).

2. Investigation of mismanagement or wrongdoing

Another proper purpose is investigation of potential wrongdoing or mismanagement.¹⁸ Stockholders may use information about corporate mismanagement, waste, or wrongdoing in several ways. They may institute derivative litigation, seek an audience with the board of directors to discuss proposed reform, prepare a shareholder resolution for an annual meeting, or mount a proxy fight to elect new directors.¹⁹ The stockholder, to meet its burden under § 220 with respect to demonstrating the proper purpose of investigating mismanagement, must show “by a preponderance of the evidence, a credible basis from which the Court of Chancery can infer there is possible mismanagement that would warrant further investigation”²⁰ Neither “mere suspicion” of wrongdoing or mismanagement, however, nor an interest in investigating “general mismanagement, without more” is sufficient.²¹

¹⁸ *Seinfeld v. Verizon Commc'ns, Inc.*, 909 A.2d 117, 121 (Del. 2006) (citation omitted).

¹⁹ *See id.* at 119-20 (quoting *Saito v. McKesson HBOC, Inc.*, 806 A.2d 113, 117 (Del. 2002) (internal punctuation omitted)); *see also Shamrock Activist Value Fund, L.P. v. iPass Inc.*, 2006 WL 3824882, at *1 n.8 (Del. Ch. Dec. 15, 2006) (“§ 220 serves significant functions beyond those of arming potential fiduciary duty plaintiffs who have been encouraged to hone their claims with one of the ‘tools at hand’ provided by § 220.”).

²⁰ *Seinfeld*, 909 A.2d at 123.

²¹ *Id.* at 122-23.

Robotti claims that by the time the anti-dilution provisions were fully implemented, Gulfport had issued 16.2 million shares to raise \$12 million in capital, which would effectively equate to a share price of approximately \$0.70 per share.²² No one actually purchased shares at that price, but Robotti presents that share price as an average measure of the actual benefit/detriment to the corporation. Robotti also offers, as evidence of mismanagement, that the Board of Directors authorized such an odd distribution because it worked to the benefit of management and the controlling shareholder. According to Robotti, although rights offerings are typically priced at a discount to market value, the discount in this instance vastly exceeded the market norm. References to trading price may not be especially useful as a point of comparison in this instance, because the trading in Gulfport shares was limited and it had a control shareholder. Robotti also argues that management failed to disclose its reasons for selecting such a low offering price. Essentially, its position is that, although management disclosed vague reasons for requiring quick financing, it did not inform the stockholders of why a price that would trigger the management-friendly anti-dilution provisions was necessary. Robotti also argues that management was aware that, due to the

²² Trial Tr. at 85.

low price of the offering, the backstop agreement was unnecessary. Robotti finds suspicious that CD Holdings, as the beneficiary of the backstop agreement to the offering, also received some of the proceeds of the offering as a payment for its outstanding credit account with Gulfport. According to Gulfport, the presence of the backstop agreement was part of the reason why shareholders were willing to participate in the offering, as it minimized their risk.²³

Gulfport claims it needed to quickly raise money in order to take advantage of a rare opportunity in energy exploration, and the offering was its best option. Robotti claims that the primary motivation behind pricing the offering so low was to activate the anti-dilution provisions to the benefit of corporate insiders.²⁴ Gulfport points out that Robotti participated in the offering, and, as a result of that participation, its ownership position was not diluted by the offering. That argument is unavailing; the point is not whether Robotti's overall position was diluted, or that the controlling shareholder's overall position was increased, but

²³ Transcript of Post-Trial Oral Argument ("Post-Trial Tr.") at 30.

²⁴ Robotti also argues that the drilling program was all but complete by the time of the rights offering, but fails to respond to Gulfport's clarification that Robotti's interpretation of its press releases concerning the drilling program was erroneous.

that Gulfport's *pre-offering* shares were generally diluted because of the triggering of the anti-dilution provisions.²⁵

At the heart of Robotti's arguments is the notion that, although each of the factors argued could individually be legitimate management decisions, taken as a whole they present some credible evidence of possible mismanagement. The structural advantage to the controlling shareholder of the anti-dilution provisions, the low price of the offering (just low enough to trigger the anti-dilution provisions, and perhaps coincidentally not higher than the strike price), the fact that no factors were listed in the prospectus to show why the price of the offering could not have been at a discount that would still have allowed it to be higher than the anti-dilution strike price, the fact that CD Holdings was given a backstop agreement that turned out to be unnecessary, and that the timing of the oil drilling leaves open the possibility that alternative financing was available, are together problematic. Each of these decisions, reviewed independently, may not alone constitute credible evidence of mismanagement, but, when viewed together, the totality of circumstances becomes evidence of possible mismanagement. In sum, Robotti has cobbled together sufficient evidence, taken as a whole, to satisfy the

²⁵ That consequence, of course, standing alone, does not suggest any impropriety.

threshold credible evidence standard. It may be that each of the decisions individually was valid, but collectively, they demonstrate the possibility of a violation of fiduciary duty owed to minority shareholders because of the offering.

Gulfport also partly responds with a generalized argument that controlling shareholders are not required to give up contractual rights in order to confer benefit on minority shareholders. That, however, is distinct from Robotti's allegations which turn on a decision to raise capital in a way that triggers a controlling shareholder's contractual right in spite of either (i) a lack of necessity for the decision or (ii) a viable or preferable alternative to the financing that has a less negative impact on minority shareholders or the corporation.

In sum, Robotti has established a proper purpose for inquiring into the offering.

Robotti also seeks to investigate two lines of credit obtained by Gulfport. One of the revolving lines of credit, the Gulfport Funding Agreement, is not relevant to the offering at issue in this case; it was entered into on May 22, 2001, and was extinguished before the offering. No other plausible basis for inquiry has been specified. The CD Holdings credit facility presents, however, a different question. Through the prospectus disclosure of its intention to use proceeds from

the offering to pay off the CD Holdings credit facility, Gulfport has made information concerning that facility pertinent to the offering and, thus, a proper topic for inspection.

Robotti challenges Gulfport's decision to pay certain dividends owed to holders of Gulfport's Series A preferred stock with Gulfport common stock. Robotti does not suggest that the common stock that was issued was not equivalent in value to the dividends that were owed. Instead, Robotti suggests that such an action is unusual or "odd."²⁶ That, however, is not any evidence of wrongdoing and, thus, offers no basis for any inference with respect to potential wrongdoing.

B. *Scope of Inspection*

Robotti bears the burden of demonstrating that each category of books and records which it has identified is essential to accomplishing its proper purpose.²⁷ Indeed, it is the duty of the Court to limit any inspection to those documents that are "necessary, essential, and sufficient for the shareholder's purpose."²⁸

²⁶ Trial Tr. at 34.

²⁷ See, e.g., *Sec. First Corp. v. U.S. Die Casting & Dev. Co.*, 687 A.2d 563, 569 (Del. 1997).

²⁸ *Carapico v. Phila. Stock Exch., Inc.*, 791 A.2d 787, 793 (Del. Ch. 2000); see also *Highland Select Equity Fund, L.P.*, 906 A.2d at 164. For the most part, Robotti's requests cannot fairly be criticized as stalking horses for the broad access granted under litigation-based discovery rules. Cf. *Sec. First Corp.*, 687 A.2d at 571.

Gulfport also argues that its public filings should be sufficient for Robotti's purposes and, thus, access to certain minutes of Gulfport's Board is not necessary.²⁹ The Court, in certain circumstances, may limit a books and records inspection to the extent that information is available in public filings.³⁰ Because Board minutes are not publicly available, and although "a" possible purpose has been disclosed for the offering in the public filings, they may disclose that "the" real purpose is different.

C. *Review of the Specific Demands*

With the conclusion that Robotti has presented credible evidence as to potential wrongdoing or mismanagement with respect to the offering, the Court also finds that its requests are narrowly tailored and necessary and essential for its

²⁹ See Post-Trial Tr. at 32.

³⁰ See DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY § 8.6[g], at 8-126.17 (2007) ("While the public availability of all information necessary and essential to a stated purpose will support the denial of inspection, the Court will carefully assess the sufficiency of the public information for the stated purpose and, if appropriate, will more narrowly tailor relief to the extent that the stated purpose can be served by reference to public sources."); see also *DPF, Inc.*, 1975 WL 1963, at *2 (concluding that the plaintiff was not entitled to engage in a "fishing expedition" when certain information requested and pertinent to valuation was already accessible by virtue of the company's registration with the Securities and Exchange Commission and listing on the New York Stock Exchange). See also *Petition of B & F Towing and Salvage Co., Inc.*, 551 A.2d 45, 51 (Del. 1988).

proper purpose. Accordingly, inspection will be directed as to the following categories:

Demand 1: Minutes of all the Board of Directors meetings wherein the stock subscription price of \$1.20 as reflected in the July 22, 2004 Prospectus was established and or discussed.

Demand 2: Minutes of all the Board of Directors meetings wherein the backstop agreement with CD Holdings was approved and/or discussed.

Demand 3: Minutes of all the Board of Directors meetings wherein alternatives to the backstop agreement were discussed and/or considered.

Demand 9: Minutes of the Board of Directors meetings wherein the subscription rights offering, as reflected in the Prospectus, were discussed, considered, and/or approved.

Demand 11: Minutes of all the Board of Directors meetings wherein the dilutive effects or potential dilutive effects of the Rights Offering were discussed and/or considered.

Demand 12: A list of all persons who hold the warrants for the current exercise \$4.00 per share referred to on page 22 of the Prospectus.³¹

Demand 15: Minutes of all the Board of Directors meetings wherein the Board considered and/or approved of the \$3,000,000 revolving credit facility with CD Holding LLC.

Demand 16: Minutes of all the Board of Directors meetings wherein the Board considered alternatives to the CD Holding LLC revolving credit facility.

* * *

Because Robotti did not present some credible evidence of potential wrongdoing or mismanagement with respect to the decision to pay dividends due the holders of Series A preferred stock with Gulfport common stock, the following demands are denied:

Demand 4: Minutes of all the Board of Directors meetings wherein the decision to pay the Series A preferred stock in additional shares, including but not limited to obtaining and receiving the consent of such holders (the “PIK Preferred”), was discussed and/or approved.

³¹ The \$4.00 warrants have all been exercised and, thus, there are no current holders. The demand fairly encompasses the identity of those who may have benefited from the rights offering.

Demand 5: A list of all shareholders of the Series A preferred stock.

Demand 6: The consents of the holders of the Series A preferred stock referred to on page 8 of the Prospectus and the communications with such shareholders regarding the obtaining of such consents.

* * *

Robotti has failed to demonstrate any proper purpose for inquiry into the circumstances surrounding the Gulfport Funding Agreement for a revolving line of credit. Accordingly, the following demands are denied:

Demand 13: Minutes of all the Board of Directors meetings wherein the Company discussed and approved a revolving line of credit agreement with Gulfport Funding LLC referred to on page 30 of the Prospectus.

Demand 14: All meetings of all the Board of Directors wherein the Board discussed or considered alternatives to the Gulfport Funding Agreement.

* * *

Because Robotti was unable to demonstrate that the books and records which it sought would assist (or are necessary to help) it value its interest in Gulfport, the following demands are denied:

Demand 8: Minutes of all the Board of Directors meetings wherein the value of the company stock and/or the value of the company as a whole was discussed and/or considered.

Demand 17: All offers or expressions of interest from third parties regarding possible acquisition of Gulfport and/or possible business combinations with or involving Gulfport.

The latter requests also suffer from the absence of any recognizable relationship to any other proper purpose.

* * *

Demand 10 seeks a subset of documents encompassed by Demand 11. Relief in an action such as this one is to be crafted to avoid duplication. To the extent that Demand 10 may be viewed as having a broader scope than Demand 11, it is not supported by any credible evidence or wrongdoing. Accordingly, the following demand is denied:

Demand 10: Minutes of all the Board of Directors meetings wherein the effect of re-pricing the PIK preferred and/or the \$4.00 per share price stock warrants was discussed and/or considered.

* * *

The following demand is denied because it has no identified link to any mismanagement or wrongdoing and, also, because it is not narrowly tailored to accommodate any need, should one exist:

Demand 7: Minutes of the all the Board of Directors meetings wherein any interested party transactions were discussed, considered, and/or approved.

III. CONCLUSION

For the foregoing reasons, Robotti's demands, presented under 8 *Del. C.* § 220, are granted with respect to Demand Nos. 1-3, 9, 11-12, 15, and 16. Gulfport shall forthwith produce those documents responsive thereto. Otherwise, the demands are denied.

IT IS SO ORDERED.

Very truly yours,

/s/ John W. Noble

JWN/cap
cc: Register in Chancery-K