

COURT OF CHANCERY
OF THE
STATE OF DELAWARE

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Re: *Electra Investment Trust PLC, et al. v. Robert D. Crews, Jr., et al.*
C. A. No. 15890

Dear Counsel:

Plaintiffs Electra Investment Trust PLC and Electra Associates, Inc. (collectively, "Electra") filed this derivative action on behalf of The Benjamin Company, Inc. ("TBC") against TBC directors Robert B. Crews, Jr., Deborah L. M. Honore, Patricia Ryan, and Robert C. Hill. Crews is TBC President and CEO, and is married to Honore. Electra alleges sundry breaches of fiduciary duty by Crews, including misappropriation of TBC funds and execution of self-dealing agreements on behalf of TBC without disclosing his conflict of interest to the board. TBC appointed a Special Litigation Committee (the "SLC") to

investigate the merits of this suit and how the company should pursue Electra's claims. After doing so, the SLC negotiated a settlement agreement requiring Crews to pay back the misappropriated funds and to rectify his other wrongful behavior. The SLC now moves for approval of its settlement agreement with Crews, together with dismissal of this litigation. Electra opposes the motion.

I am satisfied that the settlement agreement solves Crews's most egregious (alleged) abuses, but the agreement downplays the significance of some of Electra's claims without engaging in a reasonably thorough investigation of the facts underlying those allegations. For that reason, the SLC's proposed settlement agreement fails to meet the *Zapata*¹ standard. I deny the SLC's motion to approve the proposed settlement agreement.

I. BACKGROUND

TBC operates bookstores and newsstands in many of America's major airports. Before 1994, Crews was TBC's sole stockholder and has always been its top officer. Crews is African-American, which has enabled TBC to qualify for federal hiring preferences for minority-owned businesses. That fact is an integral aspect of TBC's growth strategy and relevant to this litigation because Electra seeks Crews' termination.

¹ *Zapata Corp. v. Maldonado*, Del. Supr., 430 A.2d 779 (1981).

In 1994, Crews pursued negotiations with Electra over the terms by which Electra would obtain a minority stockholder position in TBC. Initially, the parties contemplated that Crews would transfer all of his stock in his wholly-owned company, Crews of California, Inc. ("COC") to TBC and, in return, Electra would invest a total of \$10 million in TBC. Crews needed to obtain the approval of COC's lienholder, WH Smith of California, Inc., before transferring the COC stock to TBC. In light of this obstacle, Crews and Electra continued negotiations toward their agreement.

On December 20, 1994, Electra and TBC entered into a Securities Purchase Agreement (the "SPA") by which Electra paid TBC \$6.5 million for (i) 2,000 shares of TBC Senior Convertible Preferred Stock (the "Preferred"), convertible into 22% of the outstanding fully-diluted common stock; (ii) warrants to purchase up to an additional 15% of TBC's outstanding common stock on a fully-diluted basis; and (iii) Senior Subordinated Notes due in 2000 in the principal amount of \$4,550,000. They also agreed that Electra would invest an additional \$3.5 million if TBC could arrange a lien-free transfer of Crews's COC stock to TBC by February 28, 1995. TBC failed to reach agreement with WH Smith before the deadline passed.

Crews and Electra, TBC's only shareholders, also entered into a Shareholders Agreement on December 20, 1994. Under this agreement, Crews and Electra agreed that TBC would have 5 to 7 directors, including two Electra appointees. At the time of the dispute, the TBC board was comprised of four

Crews's appointees (Crews, Honore, Hill, and Ryan) and two Electra appointees, Scott D. Steele and Carl C. Cordova, III.

The same day that the parties executed the SPA and Shareholders Agreement, Crews and TBC entered into the TBC Employment Agreement appointing Crews as president and CEO of TBC with an annual salary of \$250,000 plus bonuses. The Employment Agreement provided that Crews would "devote substantially all of his business time" to TBC. The agreement allowed TBC to terminate Crews if he were to commit a felony or fail to perform his duties to the material detriment of TBC.

After acquiring a stake in TBC, Electra protested on a number of occasions what it perceived to be excessive use of company funds by Crews and unfair dealing between TBC and Crews's other companies or cronies. According to Electra, Coopers & Lybrand, LLP ("C&L") raised similar concerns about TBC senior management's unethical use of funds as its reason for refusing to issue an opinion on its audit of TBC.² On July 18, 1997, Steele (one of Electra's appointees) proposed that TBC terminate Crews's employment because of the above-described abuses. Only Steele and Cordova (Electra's other representative on the board) voted in favor, while Ryan, Hill, Honore, and Crews voted against the approval. Not satisfied with TBC's response, Electra filed this derivative action, claiming that Crews and the other defendants had

² See letter from C&L to Crews (Oct. 27, 1997), in SLC Report, Ex. 13, Att. A (questioning integrity of Crews and TBC's financial officer).

breached their fiduciary duties to TBC. Electra claims that Crews improperly spent over \$425,000 of TBC corporate assets, including:

- (1) the unlawful use of \$325,000 of the Company's money to purchase a private residence in California;
- (2) monthly alimony payments to his ex-wife;
- (3) monthly child support payments to his illegitimate child, payments that Crews recorded in TBC's books and records as having been made for company cleaning supplies;
- (4) personal expenses incurred by Crews and his wife to travel between TBC's offices in New Jersey and their home in California and summer residence in Martha's Vineyard, Massachusetts; and
- (5) the accrual of \$60,000 in TBC funds for Crews' unused vacation, sick, and personal time in contravention of TBC's policy of not accruing time for senior personnel.

Electra also alleges that Crews engaged in self-dealing, including:

- (1) entering into a disadvantageous business transaction with Driver-Eddy Construction Co., a company whose president and vice-president of operations was his then-fiancee (and current wife), Honore's, in-laws by her previous marriage;
- (2) causing TBC to overpay his then-fiancee, Honore, for services provided;
- (3) misappropriating TBC funds to invest in COC, Crews's wholly-owned company; and
- (4) entering into an employment agreement with COC in violation of his obligation to devote his time and efforts to TBC.

Finally, Electra seeks to have TBC recover damages from Ryan (one of Crews's board appointees) as a result of a consulting agreement signed between TBC and a company of which she was president and her husband was the

consultant. Electra alleges that none of these transactions were approved by the board and that many were undertaken without informing other directors.

In response to the lawsuit, on September 19, 1997, TBC's board appointed Ryan and Hill to the SLC and granted them the authority to investigate all of Electra's derivative claims except the one pertaining to Ryan and her husband³. The parties stipulated to a stay of this litigation while the SLC conducted its investigation. On April 24, 1998, the SLC issued a report outlining its findings and recommending acceptance of the settlement of claims proposed by Crews (the "Settlement Offer"). The key terms of the Settlement Offer are:

1. Crews would execute and deliver to TBC a promissory note in the aggregate principal amount of \$325,000.
2. Crews would execute and deliver to TBC two promissory notes in the aggregate principal sum of (i) \$60,000, bearing interest of 8% and, (ii) \$117,334.29, bearing interest at 3%.
3. In connection with any airfare or related travel expenses incurred by Crews with respect to more than one trip per month to the greater Los Angeles metropolitan area, or other expenses in excess of \$1,000 in any particular instance incurred by Crews for which he seeks reimbursement from TBC, if the chairperson of TBC's Audit Committee should determine that all or some portion of such expenses were not incurred for an appropriate business expense, Crews would not request reimbursement from TBC.
4. In connection with any future transaction (other than transactions of the type described in ¶ 3 above) between TBC and/or any of its subsidiaries, on the one hand, and Crews and/or his spouse, siblings,

³ All directors voted in favor of the resolution to establish the SLC except for Steele and Cordova who abstained from voting pending further review. See Plf.' Br. Opp. Special Litig. Comm.'s Mot., Exhibit 6, at 4. Nothing appears to be in the record that tells me the result of their further review or subsequent vote.

or lineal descendants, on the other hand, Crews would treat any such transaction as being governed by § 144 of the Delaware General Corporation Law, whether or not such transaction is actually covered thereby, and would comply with the provisions thereof prior to the consummation of any transaction.

Crews conditioned his offer upon the SLC's recommendation that TBC not pursue this action.

II. PARTIES' CONTENTIONS

The parties agree that *Zapata Corporation v. Maldonado*⁴ and its progeny articulate the legal standard governing this Court's decision whether to grant the SLC's motion. Under *Zapata*, a special litigation committee must show that its recommended action is not only fair, but that it resulted from a thorough investigation undertaken by disinterested, independent directors who made reasonable efforts to investigate the claims in good faith.⁵ As to the outcome of that analysis in this instance, the parties heartily disagree.

The SLC believes that the settlement agreement is a good faith effort to settle Electra's meritorious claims. As for the instances where the agreement does not provide recompense for possible past harms, the SLC concludes either that Electra's allegations are misplaced, that the past harms would be hard to quantify, that preventing future reoccurrences is an adequate remedy, or that

⁴ Del. Supr., 430 A.2d 779 (1981).

⁵ *Id.* at 788-89.

TBC should not waste its time and efforts pursuing claims of alleged wrongdoing that resulted in negligible harm. In particular, I note the SLC's findings on three issues:

A. Child Support Payments

The SLC wrote:

Electra has alleged that the Benjamin Company paid Harold Boignon approximately \$500.00 per month for child support payments which were falsely portrayed on the books as cleaning supplies, [sic] Mr. Crews vigorously contests the issue. At present, the amount in dispute is approximately [\$]2,618.00. The evidence offered by Electra is based solely on hearsay and inference and the Committee recommends that further investigation is not required. Regardless of the substance, it is clear that the payments ended in April, 1995. It is not in the best interests of the Company, nor is it cost effective, to pursue litigation to seek payment of \$2,600.00 nor would it be prudent to seek Mr. Crews [sic] dismissal over such a claim.⁶

Electra notes that Crews's first response to Electra's illegitimate child payment allegations was that he did not know the identity of Harold Boignon, the grandfather of Crews's alleged child. Then, in an interview, Electra points out, Crews admitted that Boignon was the father of a woman who moved to California, pregnant with the child of a Wall Street acquaintance. Crews explains that he met Boignon through the woman, whom he came to know only after she became pregnant. The woman allegedly introduced Crews to Boignon because the latter sold cleaning chemicals used to prevent damage to books by dust. Crews purchased the chemicals for use in TBC's stores.

⁶ SLC Report at 74.

Electra acknowledges that Crews vigorously denies this claim, but argues that the vigor in Crews's denial more properly characterizes his ability to switch stories on the fly. The SLC's response is that Electra's claim is hearsay not worth the cost of investigating and notes that the cost of litigating over a mere \$2,600 vitiates any possible value to TBC of obtaining an award against Crews.

Ultimately, I find the SLC's argument unpersuasive. Faced with the possibility that a shareholder will derivatively pursue that claim and the need for the Court to review any settlement reached by the SLC, however, I see greater value in a detailed examination of the merits of this claim. The mere recital of the SLC's conclusion that a particular claim is not worth pursuing effectively leaves this Court with no record to review. I cannot determine whether the decision is reasonable in light of the facts, because the SLC provides no facts.

I do not quibble with the need to factor cost into the SLC's decision as to how far to pursue its investigation. An SLC need not chase potential witnesses to the four corners of the globe to testify on a \$2,600 dispute, but a phone call or two to Boignon and his daughter would not have drastically raised the cost of the SLC's investigation. Such efforts might have provided the facts necessary for the SLC to reach the *merits* of this claim and would have potential value for the SLC and the Court in examining Electra's remaining claims. In particular, when the main defendant's integrity is called into question by evidence that contradicts his statements in regard to other claims, the SLC's exoneration of Crews in this matter would have added to his credibility. In contrast, what is the

significance of the SLC's failure to pursue this issue? The SLC's report concludes that the math dictates not pursuing this claim. But without even an effort to investigate the claim, the SLC's recommendation is effectively unsupported. It leaves the Court with no tenable basis upon which to assess the SLC's recommendation.

B. C&L's Refusal to Issue an Opinion On Its Audit

C&L refused to issue an opinion of its audit of TBC because it perceived "that there is a level of mistrust and there are questions of integrity and objectivity between the two officers of the Company." Electra believes that C&L questioned the same financial abuses alleged in Electra's complaint. Crews argues that the mistrust reflected tension between him and TBC's chief financial officer, Robert Brondo. Crews states that Brondo refused to sign off on TBC's financial statements because TBC had informed Brondo that his employment contract would not be renewed.

The SLC's investigation into the matter relied exclusively upon Electra's allegations, Crews's responses, and the summary of a telephone conference between Jack Jackson, Crews, Hill, and C&L.⁷ In its findings, the SLC determined that Electra's claim was without merit because C&L's refusal to

⁷ See SLC Report at 35-36. Jack Jackson is Crews' personal attorney. Jackson prepared the summary of the telephone conference. Parenthetically, I note also the troubling fact that Hill and Ryan were first informed that they were likely candidates for the SLC by Jackson, and that Jackson may have assisted Hill and Ryan in obtaining Delaware counsel to represent the SLC in this matter. These circumstances (and others) bear importantly on the question of the SLC's independence, an issue that I am not required to resolve given my disposition of this motion on other grounds.

issue an opinion on its audit stemmed from the reasons given by Crews. Yet, the SLC never contacted C&L directly. Instead, it relied on a summary, written by Crews' personal attorney, of a conference call in which the main target of the SLC's investigation, Crews, *participated*. The SLC argues that its conclusions were reasonable in light of the information that it considered. But that misses the point. The deficiency is in the scope of the SLC's investigation and the breadth of the information examined. Apparently, the SLC never contacted C&L directly to learn why the accounting firm would not issue an opinion. The SLC's failure to conduct such a fundamental and simple inquiry constitutes a failure to pursue adequately and independently the facts necessary to its investigation.

C. Travel & Entertainment Expenses

In its report, the SLC documents a number of entertainment and travel expenses disputed by Electra, and it records Crews's rebuttal to Electra's claims. In making its findings of fact, the SLC concludes: "While the Committee would encourage both prudent travel and expense in the future, it would not be cost effective to further investigate this claim." The SLC report adds that travel and entertainment are integral parts of Crews's job. The SLC rejects engaging in the effort and expense of retracing Crews's travels and auditing his entertainment activities.

In light of the information gathered, none of the SLC's conclusions are unreasonable on their face, but it is the scope of the underlying investigation

that I find most troubling. Apparently, the SLC concluded that it could halt its investigation of this claim after talking with Crews. No outside source of information was contacted to verify or contradict Crews's version of the facts. Instead, I am left with the task of evaluating the SLC's conclusion based upon a record composed of Electra's and Crews's opposing versions of what happened. The factual vacuum underlying the SLC's conclusions prevents me from finding that the SLC's investigation was reasonably thorough. Because I find sufficient cause to reject the SLC's settlement proposal in light of the above problems, I need not consider the other arguments asserted by Electra in opposition to the SLC's motion⁸.

III. CONCLUSION


I am mindful of the SLC's efforts to draft a settlement in the best interests of TBC. In many respects, the SLC does an admirable job of addressing the issues raised by Electra. In particular, Crews' promise to repay allegedly misappropriated funds gives Electra the remedy that my reading of the complaint indicates is most suitable. At the same time, in the three areas described above, the SLC engaged in a pattern of glossing over Electra's claims, pointing out that the underlying facts are disputed without even attempting to investigate or resolve the dispute. Instead, the report offers pat remedies without making findings of fact. And the Settlement Offer, while seeking to

⁸ Specifically, Electra also argues that the SLC has not demonstrated its independence and claims that other conclusions of the SLC were not reasonable.

prevent future harms, fails to remedy some of the injuries alleged to have already occurred. In short, the SLC's selective investigation and its package of piecemeal reforms do not adequately address all of Electra's claims. Thus, even though I am satisfied with many of the substantive terms of the Settlement Offer, I cannot conclude that the SLC's investigation was reasonably thorough. I decline to approve the settlement as presented or to dismiss the action.

IT IS SO ORDERED.

Very truly yours,


William B. Chandler III

cc: Register in Chancery (NCC)