SEMAPHORE

Newsletter of the Maritime Law Association of Australia and New Zealand

Delaware Judge Unwinds "Unfair" Merger

A 2018 merger of two entities involved in excavation of a 1717-wrecked fully-rigged gally was deemed to have unfairly diluted a significant stakeholding of "minority shareholders" to purposely inflate the shareholding of two individuals and has consequently been unwound in a judgment by Vice-Chancellor Nathan Cook of the Court of Chancery of the State of Delaware.

Buddenhagen v Clifford [2024] 2019-0258-NAC arose following explorer Barry Clifford's discovery of the 1716-built Wydah Gally off the coast of Cape Cod (Massachusetts) in 1984 and subsequent arrangements entered into to fund recovery of pirate gold from the former passenger, cargo and slave ship. The gally had been captured by pirate Captain Samuel "Black Sam" Bellamy on the return leg of its maiden voyage on the "triangle trade".

Plaintiff Paul Buddenhagen, who was engaged as a business consultant by Clifford-founded Maritime Explorations Inc (MEI) between 1991 and 1996 – and became a shareholder in lieu of some services/payments rendered – brought the action against MEI directors and shareholders Clifford and Robert Lazier to challenge:

1. specific incidents of alleged fiduciary misconduct by the two directors (the Defendants) over the past three decades
2. an allegedly unfair 2018 merger (the Merger) that the Defendants caused MEI to enter into and for which the Plaintiff sought rescission

A model of the Wydah Gally sourced from Wikipedia (photo credit: jjsala)

"In January 2017, Defendants engaged attorney Erik Bergman to assess MEI's corporate affairs and facilitate a stock-for-stock merger with [Whydah] International (ie, the Merger)," stated the judgment.

"Bergman recounted the impetus for the Merger as inspired by a demonstrated need for 'corporate hygiene, to allow the company to set itself up with a cleaner basis for moving forward' ... however, the record also suggests another, more self-serving purpose for the Merger – to deprive MEI's stockholders of the benefits provided under the Sliding Scale."

Founded by Lazier, Whydah International "with help from Clifford and Phillip Crane (a lender and co-investor)" in late 1995 had acquired the entire stake in the Wydah Joint Venture owned by Wydah Partners Limited Partnership (WPLP) – a company which was owned by further investors to those involved in two original "private placements" established between 1983 and 1986.

The "Sliding Scale" (image from judgment provided below) was introduced as part of the joint venture, which was executed in early 1987 between MEI and its wholly-owned subsidiary Maritime Financing Co Inc (MFC) and between MFC and WPLP. Under the Sliding Scale, proceeds relating to the Wydah Gally were apportioned between MEI/MFC and WPLP in accordance with a tiered formula.

Column A Level of Proceeds	Column B Operations Fee to Explorations	Column C Maritime	Column D Partnership
$ - 6,000,000	20%	0%	80%
6,000,001 - 12,000,000	0%	30%	70%
12,000,001 - 18,000,000	0%	40%	60%
18,000,001 - 24,000,000	0%	50%	50%
24,000,001 - 30,000,000	0%	55%	45%
30,000,001 - 36,000,000	0%	60%	40%
36,000,001 - 42,000,000	0%	65%	35%
42,000,001 - 48,000,000	0%	70%	30%
48,000,001 - 54,000,000	0%	75%	25%
54,000,001 - and up	0%	80%	20%

The judgment stated that the Defendants' initial goal for the 2018 Merger was:

> *To end up with Barry [Clifford] holding 76% of the surviving company (new MEI), Bob Lazier holding 15% of new MEI and other MEI stockholders holding 9% of new MEI, with Bob and Barry having a preference on dividends and distributions by new MEI of [US]$4,000,000.*

"This plan would dilute MEI's minority stockholders from their collective holding of roughly 49% of pre-merger MEI to a holding of less than 10% in post-merger MEI (new MEI). It would also function to terminate the Whydah Joint Venture and, with it, the sliding scale ...

"Of note, Defendants were the only ones negotiating the Merger on MEI's behalf – against themselves. And before approving the Merger Agreement, Defendants never once met formally as the MEI Board 'to discuss the merits of the Merger from MEI's perspective'.

"Defendants also rejected Bergman's advice to bring in a valuation expert to conduct an independent appraisal or valuation of MEI. Indeed, Defendants did not bring in *any* financial advisor. Moreover, the Merger was not approved by any independent directors or a special committee. And it was not

conditioned on an independent vote by the disinterested minority stockholders. Instead, the minority stockholders only first heard about the Merger through the Information Statement."

Vice-Chancellor Cook stated that the "Plaintiff awoke to raise these claims only after learning that the defendants caused MEI to merge with an entity the defendants owned".

"The defendants undertook the Merger in anticipation of a significant payout and their belief they were close to uncovering the 'mother lode.' Lacking any semblance of fair process and no reasonable metric for evaluating the fairness of the price, the defendants used the Merger to grant themselves additional equity and to extract rights to a substantially-greater share of the Whydah assets, all to the detriment of the minority stockholders.

"Under the facts presented here, the plaintiff prevails on this timely Merger claim, and rescission is the appropriate remedy."

The parties have been ordered to confer on a form of final order implementing the decision and to submit a joint letter advising the Court of any issues that may remain to be addressed.

However, Vice-Chancellor Cook found in favour of the Defendants in regard to the non-Merger claims and theories of liability.

"Despite being on inquiry notice of his potential non-Merger claims many years prior, the plaintiff did not act. And for 23 years, while roosting atop his claims, the plaintiff continued his slumber. In that time, the defendants have become severely prejudiced in their ability to mount a defense. Indeed, among other things, two individuals who would have been key witnesses died. This includes one of the two defendants in this action. Likewise, a flood destroyed many of MEI's documents and records several years before the plaintiff initiated this action.

"It would undermine the equitable principles embodied in the doctrine of laches to find for the plaintiff on the claims challenging acts that took place decades ago. Among other things, those principles are concerned with the natural decay of evidence over time and a defendant's ability to mount a defense with available evidence. That is, with the passage of time comes the increasing risk that evidence that may have once been available to prove a defendant's case has succumbed to the destructive forces of nature. Indeed, under circumstances like these, such delayed claims pose a substantial risk of unjust outcomes. There is a serious risk that a defendant will be held liable either because he bears the burden of proof and can no longer obtain exonerating evidence or, more perniciously, because only the evidence damning him was, by chance alone, not the subject of decay.

"Delaware law thus compels me to reject the plaintiff's delayed claims."

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