IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

ZEN INVESTMENTS, LLC	:	CIVIL ACTION
	:	
v.	:	NO. 06-1112
	:	
UNBREAKABLE LOCK COMPANY et al.	:	

MEMORANDUM AND ORDER

Juan R. Sánchez, J. **June 2, 2006**

Zen Investments LLC[1] asks this Court to permanently enjoin the merger of Unbreakable Lock Company and its iterations into a new corporation, Unbreakable Nation Company. Because the Stafford investors have failed to demonstrate irreparable harm if the merger is allowed to proceed and Unbreakable Lock has demonstrated the likelihood of substantial harm if it is blocked, I will deny the Stafford investors's request for a permanent injunction.

This litigation is the most recent in a long series of disputes between an inventor of an automobile anti-theft device and a group of his financial backers. The Stafford investors' four-count Complaint asks for an injunction first against the sale and now against the merger by Unbreakable, declaratory relief regarding the delivery of shares, a breach of fiduciary duty in failing to deliver the disputed shares, conversion of the disputed shares and abetting conversion of the disputed shares. Unbreakable delivered the disputed shares to the Stafford investors; thus, the only remaining question is the merger of Unbreakable Lock into Unbreakable Nation. I will deny the Staffford

[1]Zen Investments, formerly known as Stafford Investments LLC, is a newly-created entity of a family of investors including John Stafford Jr. and John Stafford III. The other plaintiff is Charlestown LLC, an investment company aligned with the Staffords. For the purposes of this litigation I will refer to the plaintiffs as the Stafford investors which conforms to the parties' usage and to other litigation outstanding between the parties.

investors' request for injunctive relief because I find no grounds on which to enjoin the merger of the Unbreakable entities.

FACTS[2]

In 1997, Robert Vito formed a corporation to market his own inventions of anti-theft devices, primarily for automobiles.[3] Vito licensed his patents for the anti-theft devices to Unbreakable. In 1998, three businessmen/investors, Sidney Levov, Joshua Smith and Humbert Powell, joined Unbreakable's board. Unbreakable raised an initial $1.5 million in 1998 and in 1999 sought private investment funds with a Private Placement Memorandum. In response to that solicitation, Charlestown LLC invested $1.8 million in Unbreakable; $1 million of the investment came from the Staffords. The two Staffords, John Jr. and John III, father and son, received two seats on Unbreakable's board in return for Charlestown's investment.

Unbreakable regularly rewarded investments, underwriting and loans from Vito and from the Staffords with warrants for stock options which were, in turn, re-priced as further consideration for loan guarantees. In 2001, the Stafford investors held 2.4 million shares or 29 percent of the company, Vito held 3.16 million shares or 38 percent of Unbreakable and other investors held 2.75 million or about 33 percent of the company. Pl.'s Ex. 40. By 2006 Vito's share had grown to 9.63 million shares or 65 percent of Unbreakable while the Stafford investors' 2.42 million shares now

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[2]An evidentiary hearing was held May 15, 2006 with testimony offered by both parties; closing argument was heard May 26, 2006.

[3]After its first corporate name change, the company was known as Lawman Armor Corporation, which then changed to Unbreakable Lock Company and its subsidiaries. By 2006 Vito had transferred his personal stock to Unbreakable Company, which in turn voted in favor of the merger with Unbreakable Nation at issue here. For ease of reference, I will refer to the corporate entities generally as Unbreakable, adding Nation as necessary.

represented only 19 percent of the company. Pl.'s Ex. 40. Among the loans for which Unbreakable granted warrants for stock options was one by Vito for $800,000 and one by the Stafford investors for $1.05 million and another guaranteeing a $5 million line of credit. The degree to which the Staffords were compensated in shares for their loans and guarantee is in dispute. The number of shares granted for the number of dollars at risk is a major point of contention between the parties but is largely irrelevant when considering an injunction request.

The Staffords changed the tone of the board meetings when they joined the board in 2001, according to Joshua Smith, the only disinterested board member to testify. I find Smith's testimony credible. Smith said the Staffords did not have the same interests as the existing board members and attempted to manage the company, which was, he said, a change for the worse. Smith stated he disagreed strongly with the Staffords' demands Unbreakable abandon its strategy of using infomercials to sell its product. Smith testified, "I think, in conclusion, as I look back on it, their [the Staffords'] interest was to enhance the weaknesses of the company and eventually take over the company."[4] Hr'g Tr. 68:3-6, May 8, 2006. Smith said, he concurred in the decision to not vote the Staffords back on to the board. The damage was done as far as Smith was concerned: he resigned from Unbreakable's board in March, 2006, because

> [i]t just got to be too much in terms of lawsuits, threatened lawsuits, the time to do exactly what we're doing right now [taking testimony]. All of this eroded and diminished the ability of the company to succeed. And there was too much time, energy, effort and resources devoted to areas which, in my opinion, were tangential to the business, not part of the business, but which impeded the business and limited the resources of the business to succeed in the marketplace.

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[4]Smith's impression is bolstered by a foreclosure notice from Trillium Holdings LLC which gave Unbreakable from June 30, 2003 until July 3, 2003 to repay $1.48 million dollars or lose the patents Unbreakable pledged to secure a line of credit from LaSalle Bank. Vito testified Trillium was controlled by the Staffords. Hr'g Tr. 41:21-24, May 17, 2006.

Hr'g Tr. 39:8-17, May 8, 2006. The litigation in both state and federal court between the Stafford investors and Unbreakable began in 2003 and will continue beyond this injunction demand.

John Stafford III testified credibly and at length about the extent of the Stafford investments in Unbreakable and the Stafford investors' perception of irregularities in the distribution of Unbreakable's shares. Stafford's focus on the dollars invested and put at risk for Unbreakable underlines my finding that the Stafford investors are making a monetary claim.

Unbreakable is in a perilous financial situation, according to Vito who testified Unbreakable owes $1.6 million in trade debts and another $1 million to a shareholder lender. Vito testified credibly he would be forced to withdraw his patents from Unbreakable to protect them if the merger is blocked. Vito licenses the patents to Unbreakable contingent on his role as president. If he resigns as president, the patent license is cancelled.

Citing the need for money, Unbreakable began sale negotiations with a consortium put together by Smith. The offering price was $3.5 million. The Stafford investors objected and filed the instant lawsuit to block the sale and to take possession of 1.2 million share certificates Unbreakable had failed to deliver after the Stafford investors exercised a re-priced warrant. This Court enjoined the sale and ordered the share certificates delivered, which they were. Vito and eleven minority shareholders, representing seventy-eight percent of the outstanding shares approved a merger of Unbreakable into a new corporation registered as Unbreakable Nation. Smith testified the merger was necessary to create a marketable company free of the ongoing litigation which troubled would-be buyers. Smith said he voted for the merger because "there are two . . . things [that] can happen. The company has [a] chance to succeed or goes under." Hr'g Tr. 98:20-23, May 8, 2006. The shareholders of Unbreakable Nation and Unbreakable voted on the merger on March 31, 2006.

Unbreakable's shareholders Vito and Levov are the sole shareholders of Unbreakable Nation. Unbreakable Nation came into being when its notice of incorporation was filed April 10, 2006. The Stafford investors renewed their injunction demand, this time asking the merger be enjoined.

DISCUSSION

The Third Circuit has been unsettled[5] on whether a plaintiff must prove irreparable harm to receive a permanent injunction, as opposed to a preliminary injunction which always requires a showing of irreparable harm. *Stolt-Nielsen, S.A. v. United States*, 442 F.3d 177, 185 (3d Cir. 2006) The Supreme Court answered the question recently, applying the standard of irreparable harm:

> According to well-established principles of equity, a plaintiff seeking a permanent injunction must satisfy a four-factor test before a court may grant such relief. A plaintiff must demonstrate: (1) that it has suffered an irreparable injury; (2) that remedies available at law, such as monetary damages, are inadequate to compensate for that injury; (3) that, considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) that the public interest would not be disserved by a permanent injunction.

eBay Inc. v. MercExchange, L.L.C., 126 S.Ct. 1837, 1839 (2006) (assuming without deciding all four factors apply to permanent injunctions).

The decision to grant or deny the motion lies within "the sound discretion of the district

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[5]In *Stolt-Nielsen, S.A. v. United States*, 442 F.3d 177, 185 (3d Cir. 2006), the Third Circuit noted a question about whether irreparable harm is a factor in deciding whether to grant a permanent (as opposed to preliminary) injunction. The Court suggested comparing *Chao v. Rothermel*, 327 F.3d 223, 228 (3d Cir.2003) (affirming a permanent injunction granted "where the moving party has demonstrated that: (1) the exercise of jurisdiction is appropriate; (2) the moving party has actually succeeded on the merits of its claim; and (3) the 'balance of equities' favors granting injunctive relief"), with *ACLU of New Jersey v. Black Horse Pike Regular Board of Education*, 84 F.3d 1471, 1477 nn.2-3 (3d Cir.1996) (*en banc*) (holding a district court considering a permanent injunction is not bound by a court's decision to impose a preliminary injunction because the court may fashion an appropriate remedy including but not limited to an injunction in deciding the merits). *But see Shields v. Zuccarini*, 254 F.3d 476, 482 (3d Cir.2001) (stating a court may grant a permanent injunction if it finds, *inter alia*, "the moving party will be irreparably injured by the denial of injunctive relief" (citing *Black Horse Pike*, 84 F.3d at 1477 nn. 2-3)).

judge, who must balance all of these factors in making a decision." *Kershner v. Mazurkiewicz*, 670 F.2d 440, 443 (3d Cir.1982). Injunctive relief is an extraordinary remedy that should be granted only in limited circumstances. *Frank's GMC Truck Ctr., Inc. v. Gen. Motors Corp.*, 847 F.2d 100, 102 (3d Cir. 1988).

To demonstrate irreparable harm, the Stafford investors must show a potential harm exists "which cannot be redressed by a legal or an equitable remedy following a trial." *Acierno v. New Castle County*, 40 F.3d 645, 653 (3d Cir. 1994). Economic loss does not qualify as irreparable harm, and an injury cannot be merely "possible, speculative or remote." *Id.* at 653-55. Irreparable harm "'cannot be repaired, retrieved, put down again [or] atoned for.'" *A.O. Smith Corp. v. F.T.C.*, 530 F.2d 515, 525 (3d Cir. 1976) (misquoting *Gause v. Perkins*, 69 AmDec. 728, 730 (1857) (describing that which cannot be "repaired, retrieved, put *back* again [or] atoned for") (emphasis added)).[6]

Under Pennsylvania law, the Stafford investors bear the burden of proving fraud or fundamental unfairness to block the merger between the Unbreakable Lock companies and Unbreakable Nation. 15 Pa. C.S. § 1105.[7] An injunction action is only available under Pennsylvania

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[6]In *Gause*, the North Carolina court analyzed at length the difference between ornamental trees in England and trees in North Carolina which produced turpentine, barrel staves and shingles. *Gause*, 69 Am. Dec. at 730-31. The court denied an injunction finding production trees were more like "[g]rass that is cut down cannot be made to grow again, but the injury can be adequately atoned for in money," 69 Am. Dec. at 730. The *Gause* decision highlights the changes in the country in a century in a half: "ours is a new country; our policy is to subdue the forest and develop its resources, and we decide, that to work trees for turpentine, or to cut down trees for staves, is not destruction, and the court cannot see that the injury will be irreparable. . . ." *Gause* at 733.

[7]Section 1105: **Restriction on equitable relief**

> A shareholder of a business corporation shall not have any right to obtain, in the absence of fraud or fundamental unfairness, an injunction against any proposed

law if it is brought before the merger occurs; post-merger remedies are limited to the appraisal of the fair value of the dissenter's stock. 15 Pa.C.S. § 1930(a); *In re Jones & Laughlin Steel Corp.*, 412 A.2d 1099, 1104 (Pa. 1980) (denying a post-merger injunction). Section 1105 can be read as providing a dissenting shareholder with the right to block a merger in cases of "fraud or fundamental unfairness." *Warehime v. ARWCO Corp.*, 679 A.2d 1317, 1319 (Pa. Super. Ct. 1996). Fraud "consists of anything calculated to deceive, whether by single act or combination, or by suppression of truth, or suggestion of what is false, whether it be by direct falsehood or by innuendo, by speech or silence, word of mouth, or look or gesture." *Barter v. Diodoardo*, 771 A.2d 835, 839 (Pa. Super. Ct. 2001) (holding side-deal offered to non-voting shareholders did not constitute fraud or fundamental unfairness entitling non-voting shareholder to injunctive relief).

The freeze-out merger is a well-recognized technique for a corporation to rid itself of troublesome minority shareholders as long as the majority has a business rationale beyond benefitting itself. Majority shareholders only violate their fiduciary duty to minority shareholders when they freeze out the minority for the sole purpose of continuing the business for the benefit of the majority. *In re Jones & Laughlin Steel Corp.*, 412 A.2d at 1102-03. Some independent rationale for a merger must be provided. *Id.*; *see also Dower v. Mosser Indus., Inc.*, 648 F.2d 183, 189 (3d Cir.

> plan or amendment of articles authorized under any provision of this subpart, nor any right to claim the right to valuation and payment of the fair value of his shares because of the plan or amendment, except that he may dissent and claim such payment if and to the extent provided in Subchapter D of Chapter 15 (relating to dissenters rights) where this subpart expressly provides that dissenting shareholders shall have the rights and remedies provided in that subchapter. Absent fraud or fundamental unfairness, the rights and remedies so provided shall be exclusive. Structuring a plan or transaction for the purpose or with the effect of eliminating or avoiding the application of dissenters rights is not fraud or fundamental unfairness within the meaning of this section.

15 Pa. C.S. § 1105 (footnote omitted).

1981) (recognizing the need to proffer a legitimate business purpose for a merger under Pennsylvania law).

Unfair dealing must be more than an unfairness in the price to be paid the dissenting shareholders for their shares for the court to enjoin the merger; the unfairness must result from non-disclosure or misrepresentation concerning some essential of the merger itself. *Barter,* 771 A.2d at 839-40. Financial unfairness is not the equivalent of fraud or fundamental unfairness. *Id.* at 841. Appraisal is the minority shareholder's remedy. *Id.*; 15 Pa. C.S. § 1930(a).

The Stafford investors are only entitled to an injunction if they will suffer irreparable harm through a merger which is fraudulent or unfair.[8] Because I find the Stafford investors have proved no fraud or fundamental unfairness, nor any irreparable harm beyond money damages, I will not grant the injunction.

The Stafford investors also claim the merger should be blocked because Unbreakable Nation allegedly approved the merger before it came into being. Equity views that which ought to have

[8]The Stafford investors argue *Warden v. McLelland*, 288 F.3d 105 (3d Cir. 2002), would allow this Court to enjoin the merger and adjudicate separately its fundamental unfairness. Pl.'s Proposed Findings of Fact at 14. The Stafford investors take *Warden* beyond its holding which was simply that a district court must explain its reasons when denying an injunction preventing a squeeze-out merger. In *Warden*, the controlling stockholder in a family business orchestrated a squeeze-out merger against his brother. The minority stockholder sought an injunction in federal court at the same time an appraisal action was proceeding in state court. *Warden*, 288 F.3d at 109. Pennsylvania permits equitable claims along with appraisal remedies where a merger is "fraught with fraud or fundamental unfairness." *Id*. at 115. The Third Circuit remanded the *Warden* case twice, asking for the district court's reasoning. The first appeal remanded the case asking the district court to supplement its one sentence order with its reasoning. The ensuing decision from the district court "was a minimally modified version of one of defendants' legal memoranda the District Court had previously listed as setting forth the legal authority for its prior order," *id.* at 110, so the Court addressed the merits and remanded the case again, asking the district court to decide whether the petitioner sufficiently pled fraud or fundamental unfairness to survive a motion to dismiss. *Id.* at 115. Rather than standing for the proposition the issues may be ruled on separately, *Warden* requires a district court to enunciate reasons.

been done as done. *McGee's Appeal*, 8 A. 237, 241 (Pa. 1887) (holding in equity considers that as done which ought to have been done and limiting remedy to that of law); *Chew v. Barnet*, 11 Serg. & Rawle 389 (Pa. 1824) (reasoning equity gives "parties a common-law remedy on an equitable title, and not of affecting their rights). Injunction is an equitable remedy. In *Barter*, the Superior Court discounted a technical problem of similar proportion in which stock certificates were issued five days before the articles of amendment authorizing their issuance were filed. *Barter*, 771 A.2d at 837. I can find no reason to grant an injunction on a similar gap in time.

The Stafford investors also argue the by-laws of Unbreakable Nation alter their shareholders rights sufficiently to cause irreparable harm. Unbreakable Nation removed most of the disputed sections of the by-laws on May 11, 2006, retaining only a right to force a shareholder to sell and adding the right to appraisal. The Stafford investors have failed to demonstrate irreparable harm because their remedy is one provided by law – an appraisal under Pensylvania Business Corporation Law. 15 Pa. C.S. § 1930(a). The Stafford investors have failed to demonstrate any harm which could not be "adequately atoned for in money." *A.O. Smith Corp.*, 530 F.2d at 525.

The Stafford investors have failed to prove or even allege the level of fraud or fundamental unfairness required by Pennsylvania law for an injunction. Unbreakable Lock demonstrated an adequate business purpose, that of financial survival, sufficient to warrant the merger. The Stafford investors testimony regarding the dollar amount of their claims against Unbreakable Lock serves to underscore that their damages are quantifiable. I will, therefore, leave them to the remedies provided by law.[9] An appropriate order follows.

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[9]The contenders in this case have two other actions based on reciprocal allegations of fraud before this Court.

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ORDER

And now, this 2nd day of June, 2006, Plaintiff's demand for injunctive relief is DENIED rendering Defendants' Motion to Dismiss (Document 17) MOOT. Plaintiffs' Motion to Exclude (Document 56) and Defendants' Motion to Modify (Document 57) are DENIED as moot. Defendants' Motion to Dismiss (Document 58) is DENIED.

BY THE COURT:

\s\ Juan R. Sánchez
Juan R. Sánchez, J.