STATE OF VERMONT

WASHINGTON COUNTY, SS.

WASHINGTON SUPERIOR COURT

DOCKET N0. S23-771Wnc

DENNIS J. SOLOMON, DEAN W. MELEDONES,

PHILLIP SOLOMON, ROBERT ELDERIDGE,

WILLIAM D . MELEDONES and JULIUS GOODMAN, Plaintiffs

vs.

ATLANTIS S DEVELOPMENT, INC.,

PATRICK E. MALLOY, III,

MARK A. MORDECAI and ATLANTIS WEATHERGEAR, INC., Defendants

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above matter came on for hearing before the Washington Superior Court on February 19, 21, 22, 26, April 14, 15, 16, 17, 18, May 19, 20, 21 and 22, 1980. The Plaintiffs were represented at the hearings by Kimberly B. Cheney, Esquire, and James S Brock, Esquire. The Defendants were represented by Robert D. Rachlin, Esquire, and Robert A. Mello, Esquire.

Upon consideration of the pleadings, the evidence, the representations of counsel, and the requests for findings and memoranda of law, the Court makes the following; findings of fact:

-1-

I. BACKGROUND

1. Atlantis Development, Inc. was incorporated as a Massachusetts corporation on February 6, 1973. It

commenced doing business in Massachusetts, but in 1974 it moved its principal place of business to Waitsfield, Vermont.

2. The stockholders of Atlantis prior to 1975 were Plaintiffs Dennis J. Solomon and Dean W. Meledones and Defendant Mark Mordecai. Together they paid in a total of $1,000 for their stock, and each one owned a one-third (1/3) interest in the company.

3. The business was operated in the nature of a partnership. All business decisions required the consent of the three shareholders prior to being implemented. All three shareholders were employees of the corporation

4. The principal business of Atlantis was the manufacture and sale of marine foul weather gear which had been designed principally by Solomon with help from Meledones and Mordecai and several individuals from the Alb Rubber Company (Alb).

5. The product was of high quality and was well received among users of recreational sailboats.

6. The product included a number of unique features, including the following: pocket closure, double cuff, double

storm flap closure, collar and hood system, the material and its neoprene coating, and the double-layer nature of the garment which allows for the dissipation of body perspiration.

7. The suits were manufactured in Somerville, Massachusetts by Alb. They were then shipped to Atlantis, which sold them in two ways: retail sales made through catalog mail order sales, and wholesale sales made directly to retailer of marine products for resale to the public.

8. As an example of the high regard in which the Atlantis weather gear was held, the entire crew of the America's Cup boat "Courageous" purchased Atlantis weather gear for themselves in 1974 despite having been given competing products for free.

9. The crew members of the Australian challenger, "Southern Cross", also purchased Atlantis weather gear for themselves.

II. BASIS OF SUIT

10. Plaintiffs' complaint alleges that they bring the action for and in behalf of themselves as stockholders of Atlantis Development, Inc. The Plaintiffs fairly and adequately represent the interests of shareholders similarly situated in seeking to enforce the alleged right of Atlantis Development,

Inc. to have rescission of-the transaction complained of.

11. Plaintiffs Solomon and Meledones did not make demand upon Defendants Malloy and Mordecai to institute this or a similar action on behalf of Atlantis Development, Inc. Such demand, if made by Solomon or Meledones, would have been futile because the individual Defendants approved and personally benefited from the transaction and continue to benefit from it.

12. This action is properly brought by the Plaintiffs on their own behalf and on behalf of Atlantis Development, Inc., in their derivative capacity.

III. FINANCIAL HISTORY

13. Prior to 1975, Atlantis was not adequately capitalized. Its capital consisted of the $1,000 capital contribution from the three stockholders and .$17,000 of convertible subordinate debentures which were purchased by Phillip Solomon (father of Dennis Solomon), William Meledones (father of Dean Meledones), Herbert Mordecai (father of Mark Mordecai), Robert Elderidge, (a friend of the stockholders) , and Julius Goodman (also a friend of the stockholders).

14. Because. Atlantis was undercapitalized, its supplier (Alb) had trouble factoring its accounts receivable. As a result, Alb was not able to fill all of the orders it received,

-4-

and Atlantis did not receive as much merchandise as it could have used. (Plaintiffs' Exhibits 2.01 and 2.02.)

15. For the fiscal year ending January 31, 1974, Atlantis had gross sales of $19,178 and a net loss of $9,346. (Plaintiffs' Exhibit 2.23.

16. For the fiscal year ending January 31, 1975, the company had gross sales of $43,649 and a net loss of $23,795. As of January 31, 1975, the. company had cumulative negative retained earnings of $33,141. (Plaintiffs' Exhibit 2.23.)

17. During the first two years of operation, advertising expenses consumed a disproportionately large portion of available funds. Such costs amounted to $10,533 for the first year (approximately 55% of gross sales) and $11,521 for the second year (approximately 26% of gross sales).

18. In January and April of 1975, the principals of Atlantis obtained a commitment from the Chittenden Trust Company, for loans totaling $35,000, but not more than 75% of the accounts receivable and finished inventory. All inventory and receivables of Atlantis were pledged to the Chittenden by a written security agreement. (Plaintiffs' Exhibits 2.10 and 2.11.)

19. Atlantis needed additional capitalization, but its applications for loans from other lending institutions were turned down.

-5-

20. In February or March of 1975, Defendant Patrick E. Malloy, III, came to Waitsfield, Vermont, with a friend who wanted to buy marine foul weather gear. Malloy was a highly successful speculator in commodities futures as well as a businessman operating out of Sag Harbor and East Hampton, Island. In 1975, he had earned income of over $100,000 and had a net worth of somewhere between one million dollars and five million dollars.

21. In 1975, Malloy was thirty-two years of age. He owned various business enterprises, including a real estate firm, a boat yard, and an interest in a condominium project. He was a graduate of Penn State University, where he had received a degree in Business Administration, majoring in accounting, in 1965.

22. Following an expression of interest in Atlantis' product by Malloy, Mordecai corresponded with Malloy, suggesting that Malloy invest in the company. Malloy was receptive in May of 1975 the three principals of Atlantis traveled to East Hampton, Long Island for two separate meetings with Malloy.

23. Financial documents, including an income statement and a balance sheet, were either given to Malloy or sent to him, and he was aware that the company was operating at a loss, was aware of the general amount of that loss and accumulated deficit,

-6-

and was aware that the principals were projecting continued losses until late in 1975, even if substantial capital or credit was available to the firm.

24.. Malloy had become interested in sailing in 1973 and believed that the Atlantis foul weather gear was superior to the product that he was then using.

25. Following extensive negotiations, Malloy agreed to invest $50,000 in the company in return for a 25%

interest in its capital stock and a provision permitting him to maintain his 25% interest in the event the convertible debenture holders elected to convert their debentures into stock.

26. One of the disputes between the parties is the Plaintiffs' contention that, in addition to promising to invest $50,000, Malloy also promised to extend credit personally or to obtain credit for the benefit of Atlantis in the approximate amount of $50,000. Defendant Malloy contends that his promise was limited to introducing the principals of Atlantis to the Irving Trust Company or other financial institutions so that the necessary amount of credit could be obtained. The Court finds that there was no-commitment on the part of Malloy that he would furnish credit personally in the approximate amount of $50,000 to Atlantis, but that he did promise to assist the company in finding the financing which it required.

-7-

IV. MANAGEMENT PRACTICES

27. One of the conditions that Malloy insisted upon when he made his investment was that Atlantis create an escrow account to hold advance payments until delivery of the product was made. Atlantis agreed to open an account in the Irving Trust Company and deposit therein sums equal to any advance payments made by customers. However, Atlantis failed to make such deposits and, instead, continued its practice of using advance payments for other business purposes.

28. When Malloy made his investment, the parties understood that Malloy would not be involved in the day-to-day management of Atlantis because he lived in New York State and had other fulltime business interests.

29. Meledones, Solomon and Mordecai agreed that they would be responsible for the day-to-day management of Atlantis. On May 16, 1975, they signed an Employment Contract, in which their rights and duties were set forth. (Plaintiffs' Exhibit 2.30.)

30. Malloy transmitted his funds to the attorney for Atlantis by letter dated May 18, 1975. Upon completion of the necessary corporate paperwork, the funds were made available for use by Atlantis on June 5, 1975.

-8-

31. In late June 1975, the dispute between Malloy and the principals of Atlantis about the furnishing of additional capital or credit by Malloy came to a head.

32. Meledones, Mordecai and Malloy met to resolve dispute. Malloy confronted the other two with their failure to abide by their agreement to open an account in the Irving Trust Company to cover advance payments by customers. Malloy was angry about this failure, and the other two were angry about his failure to provide credit, which necessitated the use of the advance payments by the company.

33. Subsequently, Malloy did initiate steps to obtain a letter of credit for Atlantis in favor of Alb, initiating an application for $20,000 on August 13, 1975. (Plaintiffs' Exhibit 2.60.) However, the letter of credit was not issued by the Irving Trust Company until October 14, 1975. (Plaintiffs Exhibit 3.10.)

34. During a meeting among all four principals on September 21, 1975, Malloy again expressed his concern that the company had not placed in escrow funds equal to the amount of customer advance payments. Meledones explained that that had not been possible because, as of May 31, 1975, the sum that would have been required was $20,685, an amount that would have made it impossible to meet any other capital needs of the company.

-9-

35. The lack of credit arrangements with Alb from June 1, 1975 to October 14, 1975 was a substantial reason for Atlantis losing up to $55,000 in sales during this period.

36. During the May meetings with Malloy, the company had projected sales for the period May 1975 to January 1976 of $183,200, which, when added to the first quarter sales of $34,276, would have amounted to gross sales

for the fiscal year of $217,000. The actual gross sales for the period amounted to approximately $197,000.

37. If the company had had a line of credit available in June of 1975 through the end of the fiscal year, it would have been able to realize sufficient additional sales to meet the projections given to Malloy by the other principals of the corporation in May,

38. Expenses for the period ending January 1976 exceeded the May projections given to Malloy by approximately $1,000.

39. During the spring and summer of 1975, Solomon spent a large portion of his time working on a sailboat which eras located at a boatyard adjacent to Lake Champlain. He would work approximately two days per week at the Atlantis office. He insisted on continuing in this manner despite requests by the other principals of the company that he spend more time on the business. Solomon's refusal to share fully in the workload resulted in serious morale problems at Atlantis.

-10-

40. Because of the various problems facing the company, Malloy was forced to take a more active role in the management of Atlantis than he had originally intended. In addition to negotiating with Alb, Malloy also assumed the function of handling Atlantis' accounts payable on a daily basis through the Irving Trust Company in New York City.

41.The stockholders agreed that Malloy should be remunerated for his services. As a result, Atlantis entered into a contract with Malloy (Plaintiffs' Exhibit 7.30) wherein Malloy agreed to use his best efforts to obtain financing for Atlantis in return for the compensation stated therein. Although dated October 1, 1975, the agreement was not signed until on or about December 8, 1975

42. Since sales were not sufficient to generate enough working capital to overcome it’s continuing losses, Atlantis again had to resort to lenders. Malloy attempted to find financing for Atlantis, but no lenders were found.

43. In October and November of 1975 Malloy lent Atlantis a total of $45,000 for working capital so that Atlantis could stay in business. Atlantis gave Malloy promissory notes in the amount of $45,000 due January 31, 1976.

-11-

V. DIFFICULTIES WITH THE SUPPLIER

44. In the period from June 1, 1975 until September 1 1975, Atlantis had two major problems with Alb: (1 Alb would refuse to ship goods unless there was some guarantee of payment and (2) those goods that were shipped were frequently found to be of inferior quality by Atlantis personnel, resulting in the return to Alb of many second-quality goods. The return of the second-quality goods disrupted Alb's production schedule

and led to worsening of relationships between the two companies.

45. From the date of Malloy's investment until approximately October 1, 1975, Atlantis continued to have more orders for products than it could fill, but Alb was reluctant to ship goods to Atlantis without some guarantee of payment.

46. Atlantis previously had had another dispute with Alb concerning shipment of goods. Because of a failure on the part of Alb to make timely deliveries during the period February 1, 1975 to May 31, 1975, Atlantis suffered an estimated loss in profits of $18,000.

47. During the summer of 1975, Atlantis asserted a right to damages against Alb for approximately $18,000 and pursued this claim through its attorney.

48. Atlantis' needs to obtain additional credit and the dispute with Alb led to the calling of a meeting of the

four shareholders of Atlantis at Malloy's home in Long Island in September. Meledones and Mordecai met with Malloy in East

Hampton on September 5 and 6. Mordecai met with Malloy in New York City on September 16 and 17 for further discussion, and all the stockholders met in Sag Harbor on September 21, 1975. At the September 21 meeting, the principals agreed to meet with the principals of Alb in an attempt to resolve all outstanding problems.

49. The four stockholders of Atlantis met with the principals of Alb in Somerville, Massachusetts on September 1975. At that time, an agreement was reached with Alb to the effect that Atlantis would pay its then-outstanding account in full promptly, but would then be entitled to take a 5% discount from each future shipment to the total amount of $9,000.

50. Prior to September 1, 1975, Alb extended 90-day terms to Atlantis on goods shipped, so that the amounts due Alb were not payable until 90 days after the shipment.

51. The other shareholders delegated to Malloy the responsibility of negotiating a written agreement based on the oral understanding with Alb.

52. Malloy subsequently entered into two written agreements with Alb. (Plaintiffs' Exhibits 2.70 and 2.71.)

VI. AGREEMENTS WITH ALB

53. Plaintiffs' Exhibit 2.70, dated October 15, 1975, provided, among other things, that Alb would manufacture and Atlantis would purchase 500 units of foul weather gear per month,

that Atlantis would pay the purchase price to Alb within 30 days of shipment, and that Atlantis would furnish to

Alb's factor, FNB Financial Company of Boston, Massachusetts, a standby letter of credit in the amount of $50,000. Other portions of agreement concerned prices and items to be manufactured by Alb and sold to Atlantis. The prices were the-same prices that the company had obtained from Alb throughout 1975 and did not change prior to January 19, 1976.

54. The terms of the manufacturing agreement (Plaintiffs' Exhibit 2.70) were not followed meticulously by the parties. In particular, Malloy obtained agreement from Alb that a $20,000 letter of credit would be sufficient rather than the $50,000 letter of credit called for in the agreement. In addition, the letter of credit expired by its terms on July 31, 1976, whereas the agreement provided that the letter of credit should expire "no sooner than December 31, 1976." The manufacturing agreement was also not followed in that Alb continued to extend 90-day terms to Atlantis rather than insisting on the 30-day terms provided for in the agreement.

55. On January 20, 1976, counsel for Alb wrote to Malloy advising him that in order to avoid problems with the factor, FNB Financial Company, Atlantis and Alb should thereafter strictly adhere to the terms of the agreement. (Plaintiffs' Exhibit 5.10).

56. Plaintiffs' Exhibit 2.71, entitled "Release Agreement", dated October 15, 1975, required Atlantis to make a cash payment to Alb in the sum of $10,152.69, which payment

-14-

would reduce the overdue balance owed Alb to the sum of $9,000. The $9,000 remaining balance was to be paid by a series of credit equal to 5% of the total invoice price of each shipment received by Atlantis after the signing of the agreement until such time as the overdue balance was eliminated completely.

57. There is a dispute between the parties concerning the meaning of the agreement. The Defendants maintain that the credits toward the $9,000 were not to be realized until payments of future invoices were made by Atlantis, while the Plaintiffs maintain that the agreement entitled Atlantis to take the credits as each shipment was received by Atlantis.

58. The language of the agreement is as follows:

"(b) Atlantis shall be entitled to periodically reduce the overdue balance of $9,000.00 by an amount equal to five percent (5%) of the total invoice price of each shipment received by them from and after the signing of this agreement until such time when the overdue balance is eliminated completely." The Court finds that the agreement contemplates that Atlantis would receive a credit at the rate of 5% per invoice amount at the time each shipment is received by it.

59. The Release and Agreement (Plaintiffs' Exhibit 2.71) is more favorable to Atlantis than the tentative oral agreement reached by the parties in their meeting on September 22, in that Atlantis was not required to pay the full $19,000 to Alb all at once, but rather was required to pay only approximately $10,000 with payment of the remaining $9,000 spread over a period of time in the form of credits, as described.

-15-

60. The more favorable resolution of the Release and Agreement negotiated by Malloy was not disclosed to the stockholders of Atlantis until after commencement of the lawsuit.

61. The written agreements (Plaintiffs' Exhibits 2.70 and 2.71) were never shown to the other shareholders of Atlantis by Malloy until. after the commencement of the lawsuit.

62. In addition to the amounts referred to in paragraph 56 above, approximately $20,000 more was due Alb from Atlantis under order number 009065. (Plaintiffs' Exhibits 3.20 and 6.17.)

63. Plaintiffs' Exhibit 2.71 provided for a 5% discount on order number 009065 if paid on or before October 24, 1975. Payment of $18,757.69 was made on that date, but the 5% discount of $996.81 on the full amount of order number 009065 ($19,936.28) was never posted to Atlantis' books.

64. From November 7, 1975 through December 24, 1975, Alb shipped goods to Atlantis on invoices which were all on 90-day terms.

65. During this same period of time, Atlantis sold raw materials consisting of cloth for the manufacture of foul weather gear to Alb on "net" terms. Atlantis was entitled to credit the value of these shipments against its account with Alb for the full amount of such sales.

66. Atlantis was also due certain sums from Alb on account of returns to Alb of second-quality manufactured goods. The total value of the credits to which-Atlantis was entitled was $17, 291.59.

-16-

68. The credits due Atlantis from Alb were applied to Alb's account by Malloy from January 24, 1976 to January 30, that also noted that Alb's invoices to Atlantis were on 90-day terms.

70. If all of the credits to which Atlantis was entitled were properly entered, then the first payment due from Atlantis to Alb on any unpaid invoice would have been in the amount of $1,873.38 on February 17, 1976. (Plaintiffs' Exhibit)

71. If all of the credits to which Atlantis was entitled were properly entered the First National Bank of Boston could not draw any sums on a letter of credit dated October 14, 1975, until after demand made on February 17, 1976, and a failure by Atlantis to make payment-of $1,873.38

72. Malloy knew, or could have learned through the exercise of a ordinary and prudent business practice, that letter of credit (Plaintiffs' Exhibit 3.10). could not have been exercised during week of January 19., 1976, and that the earliest that it could have been exercised was after demand made on February 17, 1976. Even then, it could not have been exercised for the full $20,000.

-17-

VII. SALES EFFORTS

73. In the fall of 1975, it became apparent that all-out effort would have to be made to improve sales for Atlantis. It was agreed that Meledones, Solomon and Mordecai would leave the Waitsfield area and travel to various parts of the country. Solomon was to take his yacht, Starship, to three East Coast boat shows. Mordecai was to travel to the Great Lakes area, then to Texas and southern California. Meledones was to travel to Washington State and work south along the I Pacific Coast to meet Mordecai in San Francisco

74. It was agreed that Timothy Davis, a Harvard Business School graduate, would be hired to manage the company in absence of the three principals.

75. Solomon was late to all three boat shows at Newport, Stamford and Annapolis. At the Stamford boat show he did not arrive until the last day of the show. His late arrivals had an adverse effect on cash sales.

76. During his sales trip, Solomon obtained an order from a marine mail order house, Goldberg's Marine Distributors of Philadelphia, for 550 Atlantis jackets and 400 pants. These were to be marketed under the private label of Goldberg, and the suits were to be altered slightly from those that Atlantis itself sold. The Goldberg suits would then be sold for a

-18-

cheaper price than those sold by Atlantis. The total value of the order to Atlantis was approximately $24,000.

77. Solomon telephoned the order to Julius Goodman at Atlantis in Waitsfield on October 31. Goodman in turn consulted by telephone with Meledones and Mordecai who were then on their respective sales trips. None of the three thought that the ideal of selling private label goods was a good one since it might discourage sales of more expensive items under the regular Atlantis label. Mordecai instructed Goodman not to fill order.

78. When Solomon learned of this action, he became very upset. He called Goldberg to apologize, and on November 1975, Solomon wrote a letter to the corporation resigning as an officer. In his letter he offered to sell his shares and all his interest in Atlantis for $40,000. (Plaintiffs' Exhibit 3.50.)

79. On December 10, 1975, Mordecai submitted an offer from Malloy to Solomon to buy out Solomon's interest in Atlantis for $17,000. (Plaintiffs' Exhibits 3.80 and 3.81.) This offer was not acceptable to Solomon.

80. On November 25, 1976, Davis, at the instruction of Mordecai, wrote Alb to double the order from 500 units per month to 1,000 units per month for "January and February and perhaps March." (Plaintiffs' Exhibit 3.60.)

-19-

81. In December of 1975 or January of 1976, Mordecai learned from Alb that a new size of cloth which was 54" wide was available for the manufacturing process. The lighter cloth would enable better patterns to be cut and could result in a savings of up to 55 of Atlantis' prices from Alb.

VIII SPECIAL MEETING OF SHAREHOLDERS

82. On or about December 10, 1975, a call for a special meeting of stockholders and directors of Atlantis was sent out. The notice was worded as follows:

"There will be a meeting of the Stockholders and Directors of Atlantis Development, Incorporated at its principal place of business, The Mad River Mill, Route 100B, Moretown, Vermont, on Monday, January 19, 1976, at 10:00 a.m. for the purpose of electing officers-and-directors of the corporation' and to conduct any other such business as may come before it." (Plaintiffs' Exhibit 4.01.)

83. Meledones arrived in Vermont for the meeting on January 15, 1976. He had no substantive conversations with Malloy or Mordecai about Atlantis prior to the meeting of January 19.

84. Solomon arrived for the meeting on January 18, 1976. He had no substantive conversations with Malloy or Mordecai about Atlantis prior to the meeting of January 19.

-20-

85. Malloy came to Vermont for the special stockholders' meeting on January 17, 1976. He met with Mordecai, Tim Davis and Buffi Robbins on Sunday evening , January 18 , to review the books and records of the company in preparation for the meeting to be held the following day. Meledones was invited to the meeting, but declined to attend.

86. Malloy had with him the checkbook records, which he maintained in New York. This was the first time that the records maintained by Davis and those maintained by Malloy were available together in the same place.

87. At Malloy's request, Davis had prepared financial statements.

88. A week or ten days before he meeting, Davis telephoned Malloy and told him that things had finally turned around-and that December it was quite profitable.

89. Although no one knew it at the time, the financial reports prepared by Davis were inaccurate. They overstated Atlantis net income, because Davis did not record Atlantis' payables as they accrued. Instead, he recorded them only as they were paid.

90. A few days before the meeting, Malloy learned from Alb that Alb intended to exercise Malloy's $20,000 letter of credit within a week or two unless Atlantis paid Alb's account. According to Alb's records, Atlantis' account with Alb was overdue as of January 19,1976.

-21-

91. At that time, Atlantis had outstanding obligations amounting to approximately $60,000, of which approximately $30,000 was owed to Alb.

92. When Malloy reviewed Davis' financial records on January 19, 1976, he realized that they were wrong. Instead of having a deficit of approximately $2,000, as shown by Davis' report, Atlantis actually had a much greater deficit. Malloy could not determine the exact extent of the deficit, but his best estimate, based upon his review of the books and discussions with Davis, was that Atlantis' deficit was approximately $30,000. No plan for dealing with the problem was developed at the meeting that evening.

93. At the shareholders' meeting on January 19, 1976, Malloy opened the discussion by explaining his computations and conclusions as to the financial situation. Everyone at the meeting was disturbed to discover that Atlantis once again was in dire financial condition and unable to pay its bills without another outside infusion of cash. Everyone, including Davis, agreed that the financial records Davis had prepared were wrong and that Atlantis did indeed have a deficit in the order of $30,000.

94. Malloy informed the shareholders that he had had a call from the First National Bank of Boston stating that his letter of credit in the amount of $20, 000 was to be exercised.

-22-

within the week. Malloy at that time was involved in financing a substantial condominium project on Long Island, and he was fearful that if the letter of credit was exercised, it would jeopardize the financing of the condominium project.

95. Calculations of sums actually due Alb by Atlantis varied. The amount due was $37,592.69 according to the January 22, 1976 Bill of Sale (Plaintiffs' Exhibit 5.04), or $36,670.77 as of January 30, 1976, according to Malloy's records (Plaintiffs' Exhibit 6.17). Atlantis had earned discounts of $9,996.81 against this balance. (Plaintiffs' Exhibit 2.71; paragraphs 56 and 63, supra.) It was subsequently discovered that a short shipment of $295.94 was not recorded against this balance. (Plaintiffs' Exhibit 6.21. Making adjustments for the various discounts and credits, the maximum actually due Alb was $27,299.

96. Malloy asked for payment of $45,000 on his notes, which he stated were then due.

97. Solomon asked that the meeting be recessed for ten days so that the books of the company could be checked and other solutions explored. Malloy and Mordecai objected to the ten-day request, and it was not approved.

98. Meledones requested a twenty-four-hour delay to review the situation and see what could be done. Malloy and Mordecai objected to this request, and it was not approved.

-23-

99. A number of possible solutions were discussed at the meeting. Bankruptcy was one possibility, but if Atlantis filed bankruptcy, the creditors of Atlantis, many of whom were friends and relatives of Solomon, Meledones and Mordecai, would lose most, if not all of the money that they had invested in Atlantis or were otherwise owed by it.

100. One other solution that was discussed was the purchase by Malloy of the stock of Solomon, Meledones and

Mordecai for $1, but Malloy said that he was not interested in that.

101. Finally, Mordecai asked Malloy whether he would be willing to buy the assets of Atlantis for $1 plus assumption of; certain liabilities. Such a solution would assure that the creditors of Atlantis would be paid in full, including the debenture holders, who were friends and relatives of Solomon, Meledones and Mordecai. Such a solution would also give Malloy. the option of either liquidating Atlantis in an effort to salvage as much of his investment as he could or continue Atlantis in business in the hopes that he could somehow make it profitable.

102. Solomon on asked for a ten-day postponement in the vote but none of the other three stockholders agreed to it because they believed that Atlantis' problems would not improve by delay and

-24-

and because it might not be possible-to get the four stockholders back together again in ten days.

103. Malloy did agree that if the assets were sold to him for $1 plus the assumption of liabilities, there would be a ninety-day period in which he would return the assets to Atlantis if Solomon, Meledones or Mordecai could find another buyer who would offer Atlantis a better deal.

104. The proposal was then put to a vote. Meledones, Mordecai and Malloy voted in favor of the proposal. Solomon voted against it Subsequent to the meeting, Malloy had a detailed Purchase Agreement and a Bill of Sale prepared by his attorney which he and Mordecai signed. (Plaintiffs' Exhibits 5.03 and 5.04.)

105. Solomon and Meledones did not complain at any time during the meeting of not having received adequate notice of the subject matter of the meeting. Neither of than has exercised his right under Massachusetts law to seek an appraisal of his stock.

106. After the meeting of stockholders and directors on January 19, 1976, Meledones asked for and received the corporate books of Atlantis so that he could perform his own audit of the financial condition of Atlantis. Meledones never returned the books and records to Atlantis.

107. Following the meeting of January 19, 1976, Malloy caused a new corporation to be formed under the name Atlantis Weathergear, Inc. The Certificate of Incorporation, dated January 23, 1976, was filed with the Secretary of State of the State of Delaware on January 30, 1976. (Plaintiffs' Exhibit 1.21.)

- 25 -

108. Malloy was the sole shareholder of Atlantis Weathergear, In purchasing the assets of Atlantis Development, Malloy obtained a significant tax advantage. He was able to take a tax loss on his Atlantis Development stock, writing off approximately $25,000 against his income.

109. The accumulated losses of Atlantis Development were carried forward to Atlantis Weathergear. Weathergear clamed a tax loss of $11,800 in 1976, with a $44,700 tax loss remaining to be taken (Plaintiffs' Exhibit 6.02, Note 3.)

110. Within the 90-day period following, the meeting of January 19, 1976, Malloy was contacted by a William Russell, who was interested in negotiating a purchase of Atlantis. Russell was an principal of Peter Storm, Inc., a marine foul weather gear sales company competing in the same market as Atlantis. When told the status of Atlantis' liabilities, Russell had no further interest in acquiring the company.

111. Within the same period, Malloy also received a telephone call from a Samuel Steams concerning a possible purchase of Atlantis Development. At the time, Stearns mined a business in Annapolis, Maryland, known as Hurricane Marine products, which then had accounts due and owing Atlantis of $3,500 - $3,800. To open negotiations, Stearns offered to pay

$10,000 and assume the assets and liabilities of the company. When Malloy told him he would have to pay off the 545,000 notes due Malloy and get Malloy off the $20,000 letter of credit, his interest cooled. He asked for written financial statements or balance sheets, but none were ever sent to him, and no deal was ever made.

112. No further negotiations were conducted between Malloy and Russell or Steams, and no other individuals expressed an interest in acquiring the business during the 90-day period following the January 19 meeting.

113. Atlantis Weathergear continued to carry on a business substantially similar to that which had been_carried on by. Atlantis Development. Atlantis Weathergear continued to sell products which were substantially similar in form to those sold or developed by the principals of Atlantis Development.

114. Some minor modifications and improvements were made in the foul weather pear. In addition, Weathergear offered certain new products which had not been sold by Atlantis. These included an Ultralite suit, GTX suit, sweaters, shirts, a sailing harness, flotation gear, sleeping bags and personal rescue kits. Some of these items were under consideration by Atlantis Development prior to the meeting of January 19, 1976.

115. Malloy asked an independent accounting firm to prepare unaudited statements of the financial condition of Atlantis to help him in deciding whether he should liquidate the assets or continue the operation. The independent accountants confirmed Malloy's earlier judgment that the deficit was approximately $3,000 on January 14, 1976.

116. For several months the new corporation was rim on a liquidation basis. Expenses were cut, prices were increased, and advertising was improved. It was not until June or July 1976 that Malloy concluded that the corporation could be run profitably.

117. Atlantis Weathergear prospered from 1976 through 1979. In 1976 Weathergear had retained earnings of $35,107. In 1977 its net income was $78,031 and its retained, earnings were $113,138. In 1978 its net income was $79,297 and its retained earnings were $192 ,435. On December 31, 1979 , its-net income was $80,621 and

its retained earnings were $273,056. (Plaintiffs Exhibits 6.02, 6.03, 6.04, and 6.05.)

118. At the time of trial, Mordecai was president of Atlantis Weathergear at an annual salary of $32,000. Buffi Bobbins, who had previously worked for Atlantis Development until she resigned in October 1975, was vice-president of Atlantis Weathergear at an annual salary of $22,000.

119. From the meeting of January 19, 1976, until early 1979, Meledones remained in Vermont, taking several low-paying jobs. He was not able to earn a salary commensurate with that earned by either Mordecai or Miss Bobbins.

120. The employment contract of May 16, 1975, (Plaintiffs' Exhibit 2.30) provides in paragraph 4 that in event of termination of the agreement "the royalty as specified in Section 3a of this contract will continue to be due and payable for so long, as such designs shall be produced in substantially similar form..."

- 28 -

121. Paragraph 3a of the employment contract provides for a royalty of 5% of gross sales divided among the three original shareholders or 1.66% of gross sales each.

122. Neither Solomon nor Meledones has been paid any sums on account of the royalty provisions in the employment contract

123. Solomon has not performed any of the services enumerated in the employment contract since November 12, 1975.

124. Meledones has not performed any of the services enumerated in the employment contract since January 19, 1976.

125. Meledones signed a written release of his claims under the employment contract in return for the firm automobile. (Defendants' Exhibit G.)

126. Malloy paid all of the debts of Atlantis that he agreed to assume.

127. Under the terms of the debentures, the debenture holders were entitled to be paid 110% of the face value of their debentures, plus interest at 10% per annum to the date of redemption. (Plaintiffs' Exhibit 1.03.)

128. On April 5, 1976, Mordecai wrote a letter to all the debenture holders setting forth an offer on the Dart of Malloy to pay the face value of their notes plus accrued interest to January 15, 1976. He enclosed with the letter a copy of Atlantis' January 19, 1976 financial statement.

- 29 -

129. Each debenture holder accepted the offer and returned his debenture to Atlantis in exchange for payment from Malloy,

130. After January 19, 1976, Malloy converted his $45,000 of loans to "paid-in capital"

131. Within the first six months of operation of the new corporation, Malloy loaned Weathergear an additional $47,000, which was needed for continued operation,

132. As of the date of trial, Malloy had loaned Weathergear a total of $348,000 and had also secured for the corporation a $400,000 bank line of credit which was personally guaranteed by Malloy.

133. Since January 19, 1976, Malloy has acquired a majority ownership interest in Alb. This has helped increase the profitability of Weathergear.

134. The operating experience of Weathergear has been as follows:

Year	Gross Sales	Cost of Goods Sold	Operating Expenses	Income from Operations	Net Income
1976	$ 386,827	$ 248,885	$ 102,835	$ 35,107	35,107
1977	915,315	638,750	188,484	88,081	78,031
1978	1,455,462	979,840	357,442	118,180	79,297
1979	2,033,693	1,397,012	512,451	124,230	80,621

(Plaintiffs' Exhibits 6.02, 6.03, 6.04 and 6.05)

-30-

X. EVALUATION OF ATLANTIS DEVELOPMENT, INC., AS OF JANUARY 19, 1976

135. The generally accepted method of appraising the value of a corporation's equity is: (a) to determine, where possible, the fair market value of the corporation's stock, the net value of the corporation's assets, and the capitalized value of the corporation's earnings; and (b) to give each of the three values its proper weight in arriving at a final value for the equity of the corporation.

(i) Valuation of Corporation's Stock

136. It is not possible to determine the fair market value of Atlantis' stock front sales because the stock was not publicly traded. The only sale of the stock which did occur took place under circumstances that make the sale unusable in valuing the stock as of January 19, 1976.

137. Malloy made his $50,000 investment in Atlantis in May of 1975 on the basis of representations made to him by Solomon, Meledones and Mordecai.

138. The financial condition of Atlantis on January 19, 1976 was substantially different from its financial condition in May of 1975 when Malloy became a stockholder.

-31-

139. Neither of the experts who testified (van Breda for the Plaintiffs and Laber for the Defendants) gave the fair market value of Atlantis' stock any weight in arriving at their final values for the equity of the corporation.

(ii) Valuation of Corporation's Assets

140. On January 19, 1976, the book value of Atlantis' equity was zero. Atlantis' liabilities were substantially in excess of Atlantis' assets, even assuming the assets were worth their book value.

141. The assets were not worth their book value because some of the receivables were uncollectible and had to be written off.

142. On January 19, 1976, Atlantis could have continued in business for only a short period of time unless it could find someone willing to invest large amounts of capital in the corporation. As noted previously (paragraph 131), Malloy loaned $47,000 of new money to Weathergear within the first six months of its operation.

143. On January 19, 1976, Atlantis was not in a position to pay when due the $45,000 it owed Malloy. However, as noted earlier (paragraph 130), Malloy has never been paid those loans.

144. In arriving at his final valuation, van Breda gave no weight to the zero value of Atlantis' equity.

145. In arriving at his final valuation, Laber gave a 50% weight to the zero value of Atlantis' equity.

-32-

(iii) Capitalized Value of Corporation's Earnings

146. The capitalized earnings approach attempts to value j the equity of a corporation as a going concern, and it does so by capitalizing the corporation's normalized earnings. "Normalized" earnings are the earnings that one may reasonably expect a corporation to earn for the indefinite future and that are free from extraordinary and nonrecurring factors.

147. In considering whether or not Atlantis Development, Inc. was viable, van Breda analyzed the following factors:

1. The profitability of the company;

2. How close to break-even it was on January 19, 1976;

3. The amount of sales it could expect;

4. What the market conditions were;

5. Whether or not it had sufficient cash;

6. The quality of the firm's management.

148. Following the meeting of January 19, 1976, Atlantis had financial reports prepared for it by the certified public accountant firm of Van Blarcom F, Harrison of Stowe, Vermont for the year ending January 19, 1976. (Plaintiffs' Exhibit 6.01).

- 33 -

The financial reports included a balance sheet as of January 19, 1976 and a statement of operations and deficit for the period from February 1, 1975 to January 19, 1976. The reports were not audited.

149. The Van Blarcom reports showed a loss for the year of $43,679 and negative retained earnings as of January 19, 1976, of $81,820 (common stock $51,000; deficit $30,820).

150. Subsequently, certain adjustments were made to the figures contained in the Van Blarcom financial statements, as follows:

(a) A reduction in the deficit from $30,820 to $29, 720 (Mordecai letter of :larch 17, 1976 Plaintiff's Exhibit 6.11);

(b) A reduction in the accounts payable from $52,070 to $39,697 (Plaintiffs' Exhibits 5.04 and 6.17; plus the $9,000 credit owed Atlantis from Alb).

151. The net effect of the adjustments was to reduce the deficit, from $30,820 to $17,347 and the negative retained earnings from $81,820 to $68,347, a net change of $13,473 in each instance.

152. As shown by van Breda's analysis, the working capital of the company increased by approximately $14,000 over that stated in the Van Blarcom financial reports. (Plaintiffs' Exhibit 8.20.)

153. The adjustments to the Van Blarcom financial reports result in a more accurate statement of the financial condition of the company as of January 19, 1976.

-34-

154. On January 19, 1976, Atlantis had a working-capital ratio (ratio of short-term assets to-short-term liabilities)

of 1.91. In January of 1975 the working capital ratio was 0.39. A normal ratio for a firm o£ this type would be 2.0, so by the company had improved, its working-capital position significantly.

155. If the adjustments totaling $13,473 are applied to the loss of $48,679 shown on the Van Blarcom report, an adjusted figure of $35,206 is arrived at as the loss experienced by Atlantis during the year ending January 19, 1976.

156. An analysis of the net income of Atlantis from January 1975 through January 19, 1976 shows the following:

(a) The loss for the first six months was $18,396;

(b) The loss for the-third quarter was $12,979;

(c) The loss for the last quarter was $3,830.

157. Atlantis was a typical growth company starting up and commencing business: In such a company; the initial costs are unusually high and then decline in relation to the amount of sales of the company as its business increase.

158. In the case of Atlantis, advertising costs for the year 1973 were $10,533, constituting 57.8% of gross sales. Advertising, as a percent or gross sales declined every year thereafter until 1977, when advertising costs of $33,591 amounted to 3.7 percent of gross sales. (Plaintiffs' Exhibit 8.10.)

-35-

159. Rent as a fixed cost declined from 7.7% of gross sales in 1974 to 0.8% in 1977.

160. Wages as a percent of gross sales went from 20% in 1973 to 9.8% in 1977.

161. In his analysis of Atlantis, van Breda assumed that sales would double each year for two years, that sales for the year ending January 31, 1978 would be $771,284, and that sales would increase at a rate of 10% per year thereafter. Laber agreed that this sales projection was not unreasonable.

162. In order to reach the break-even point, Atlantis would have required an increase of approximately 20% in gross sales over those of calendar year 1975. In dollars, that would have been in the order of $235,000 in gross sales, or an approximately a $45,000 increase in sales over calendar year 1975. (Plaintiffs' Exhibit 8.14)

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163. Gross sales for Atlantis Weathergear in 1976 were $386,827. (Plaintiffs' Exhibit 6.02.)

164. In order to reach the break-even point, Atlantis would have had to sell 3,533 suits in 1975. (Plaintiffs' Exhibit 8.141.)

165. In October 1975, Atlantis increased its orders from Alb to 500 units per month. In November 1975, it increased its orders to 1000 units per month for a short while.

166. 45% of the gross sales of Atlantis for 1975 occurred the three and one-half months preceding January 19, 1976.

-36-

been exercised in accordance with its terms prior to February 17, 1976. However, on January 19, 1976, Malloy believed that it would be exercised.

167. Alb shipped hoods to Atlantis on 90-day teens. Atlantis shipped goods to Alb on net-terms, meaning that the sums due Atlantis were immediately payable. Analysis of the sums due Alb by Atlantis, taking into account offsetting credits and the terms of payment, shoes that the first amount due Alb from Atlantis was on February 17, 1976 in the amount of $1,873 (Plaintiffs' Exhibit 6.21.)

168. The letter of credit obtained October 14, 1975, by Malloy for the benefit of Atlantis in the amount of $20,000 (Plaintiffs' Exhibit 3.10) could not have been exercised in accordance with its terms unless sums were due to Alb from Atlantis and the sums were evidenced by unpaid invoices transmitted to Irving Trust Company. (Plaintiffs' Exhibit 3.10.)

169. It is possible that the letter of credit might not have been exercised in accordance with its terms prior to February 17, 1976. However, on January 19, 1976, Malloy believed that it would be exercised within a few days of the January 19, 1976 meeting.

170. On or about February 17, 1976, Atlantis Development had cash in two bank accounts: the Chittenden Trust Company and the Irving Trust Company of New York, amounting to a total of $24,566.

171. The working capital position of the company was adequate to sustain its abort-term cash needs: According to van Breda's analysis, Atlantis would have required an additional $23,777 of working capital to carry on the business in 1976 and expand its sales by 100%. (Plaintiffs' Exhibit 8.12.)

- 37-

172. In evaluating the management of Atlantis, van Breda considered the figures for sales and expenses which management had projected for the year 1975 and compared them with the actual sales and expenses which resulted.

173. The budgeted expenses and the actual expenses were within $1,000 of each other.

174. The budgeted sales and the actual sales were within $20,000 of each other. Sales were adversely affected by unanticipated problems with supply from Alb.

175. The quality of management was questionable in light of the inability to keep customer advance payments separate, the fact that Malloy was forced to take over the bill-paying function, the refusal of Solomon to share equally in the work load, and the inaccuracies that developed in the record keeping after October 1975.

176. On October 1, 1975, Malloy entered into a contract with the company in which he agreed as follows:

"Malloy by his best efforts will acquire financing for Atlantis of no less than $50,000 and no more than the capitalization of the corporation will bear." (Plaintiffs' Exhibit 7.30.)

177. Subsequently, in addition to the $20,000 letter of credit dated October 14, 1975, Malloy made the following loans

-38-

to Atlantis:

October 15, 1975	October 20, 1975	October 27, 1975	November 19, 1975
$10,000	5, 000	5, 000	10,000

178. The loans bore an interest rate of 8 1/2% and were due January 31, 1976.

179. As of January 19, 1976, a reasonably prudent businessman would have called for an audit in order to arrive at a reasonable estimate of the financial condition of the company.

180. The company had sufficient working capital to stay in a holding pattern until the precise financial condition of the company could be established.

181. Using the discounted earnings method, van Breda arrived at an opinion as to the value of Atlantis Development, Inc., as of January 19, 1976.

182. The discounted earnings method requires the obtaining of a normalized earnings figure, multiplying the normalized earnings by the price/earnings ratio, and discounting; the resulting figure back to the desired date.

183. Defendants' expert, Dr. Eugene Laber, used a similar method in evaluating the company. However, he also took into

-39-

consideration the value of the company's assets in arriving at his final valuation figure.

184. van Breda arrived at a valuation of Atlantis as of January 19, 1976, of $550,000, using the discounted

earnings method. He gave no weight to the fact that the company's assets had a zero net worth.

185. Laber arrived at a valuation of Atlantis of January 19, 1976, of $7,000. Giving consideration to the fact that the net worth of the assets was zero, and that there was a 50% chance of bankruptcy, Laber arrived at a final valuation figure of $3,500 for Atlantis as of January 19, 1976.

186. van Breda also arrived at a valuation of Atlantis Weathergear as of December 31, 1979, using the discounted earnings method. He found the value of Atlantis Weathergear, Inc., to be $1,500,000 as of December 31.1979.

187. The Defendants submitted no evidence with respect to the value of Atlantis Weathergear, Inc., as of December 31, 1979

188. van Breda assumed, for purposes of his analysis, that the company would grow by 100% in each of two successive years and at a 10% rate thereafter. Laber concurred that this was a reasonable assumption and Weathergear did in fact achieve that growth rate.

- 40-

189. van Breda assumed that Atlantis' "cost of goods sold" would be 64% of net sales. However, Atlantis' actual "cost of goods sold" for the period ending January 19, 1976 was 73% of net sales.

190. The experience of the miscellaneous fabricated textile products industry as a whole in 1964 was that the "cost of goods sold" was 76.9% of net sales, and for the year ending June of 1976, 74.9% of net sales. (Plaintiffs' Exhibit 8.04.)

191. In arriving at his value of $550,000, van Breda assumed that Atlantis' fixed wages of $32,372 and its fixed costs (including interest expense) of $24,537 would remain the same for the two years January 1976 through January 1978. A reasonably prudent investor, however, would have assumed that those costs would increase because of inflation and because of additional loans both experts agreed Atlantis required.

192. In arriving at his earnings valuation of $550,000, van Breda made no provision in any of his expense projections for the salaries Atlantis would have to pay its officers and directors

193. For 12 years the profitability of comparable companies in the miscellaneous fabricated textile products industry remained approximately the same. In 1954 the composite net profit after taxes for the total industry was 1.9% of net sales. (Plaintiffs' Exhibit 8.04, page 4, line 12, last column).

-41-

In the year ended June 30, 1976, the composite net profit before taxes earned by all companies in that industry was 4.1% of net sales, and by companies the size of Atlantis, 2.6% of net sales. (Plaintiffs' Exhibit 8.04, page 1, line 14, columns A and B.)

194. In the year ended June 30, 1976 for the amusement and recreational services industry, the composite net

profit before taxes for the total industry was 3.0% of net sales, and for companies the size of Atlantis, 4.3% of net sales. (Plaintiffs' Exhibit 8.04, page 2, line 14, columns A and B.)

195. van Breda's projections result in a net profit before, taxes amounting to 17°s of Atlantis' sales.

196. In 1976, Atlantis Weathergear's net income before taxes was 9.1% of its net sales. Its net income after taxes, adjusted for a tax-loss carry-forward which was an extraordinary item, was 6.0% of its net sales. (Plaintiffs' Exhibit 6.02.)

197. A reasonably prudent investor would have taken the following factors into account in computing a price/ earnings ratio that would be reasonable to apply to Atlantis' normalized earnings: the amount of dividends Atlantis would probably pay its stockholders, the rate at which Atlantis' future earnings would probably grow, and the riskiness of Atlantis as an investment.

-42-

198. On January 19, 1976, a reasonably prudent investor would have used the following formula to compute a price/earnings ratio for a growth company like Atlantis: k (dividend payout ratio), i (discount rate), g (growth rate)

199. van Breda and Laber agreed that a discount rate of 20% would reflect how a reasonably prudent investor would If assess the riskiness of Atlantis as an investment and that 10% would reflect the rate at which such an investor would expect Atlantis'. earnings to grow after January 31, 1978. :The experts disagreed, however, over what dividend payout ratio to use in the numerator of the price/earnings ratio formula.

200. A reasonably prudent investor would have assumed, and it is reasonable to believe, that, if Atlantis survived and became profitable, its dividend payment would be consistent with the dividend payments of comparable companies in the miscellaneous fabricated textile products industry.

201. In 1964, the average company in the miscellaneous fabricated textile products industry paid out 26.8% of its earnings as dividends and retained 73.2% of its earnings to finance growth. (Plaintiffs' Exhibit 8.04, page 4, line 22, last column) In that year, companies the size of Atlantis paid out 24.6% of their earnings as dividends and retained 75.4% (Plaintiffs' Exhibit 8.04, page 4, line 22, column A.)

-43-

202. In the year ended June 30, 1976, the average company, in the miscellaneous fabricated textile products industry paid out 10.1% of its earnings as dividends and retained 89.9% of its earnings to finance growth. (Plaintiffs' Exhibit 8.04, page 1, line 24, column A. In that year, companies the size of Atlantis paid no dividends at all. (Plaintiffs' Exhibit 8.04, page 1, line 24, column B.)

203. From 1973 through 1977, six of the larger and more well-established companies in the textile products industry had dividend payout ratios ranging from a low of 30.66% to a high 40.17%, excluding 1975, which was an abnormal year in which companies generally experienced unusually low earnings (Plaintiffs' Exhibit 9.01.)

204. During this same period, again excluding 1975, the same companies showed price/earnings ratios that ranged from a low of 3.56 to a high of 9.66. (Plaintiffs' Exhibit 9.01).arrived at a price/earnings ratio of approximately. A reasonably prudent investor would not have assumed that Atlantis' would pay out in dividends 88% of its net income.

205. By using a dividend payout ratio of 88%, van Breda arrived at a price/earing ratio of approximately 10. A reasonably prudent investor would not have assumed that Atlantis would pay out in dividends 88% of its net income.

206. If Atlantis paid out 88% of its net earnings in the form of dividends, it is very unlikely that Atlantis would have been able to grow at the projected rate of 10% per year.

-44-

207. Assuming that Atlantis' sales would be $771,284 for the year ended January 31, 1978 (van Breda's assumption, concurred in by Laber), and assuming an after-tax rate of return on sales of 3%, which the Court finds to be reasonable, Atlantis' net profits after taxes would amount to $23,138.

208. If a price/earnings ratio of 6.0 were applied to Atlantis' projected normalized earnings of $23,138, a reasonably prudent investor would arrive at a capitalized earnings value of $138,831 for Atlantis equity as of January 31, 1978. The investor would then have discounted that figure back two years to January 19, 1976, and arrived at a capitalized earnings value of approximately $96,410 as of that date. ($133,831 divided by 1.20 squared, equals $96,410.)

209. On January 19, 1976, a reasonably prudent investor could have assumed that it would require additional capital of approximately $24,000 to enable Atlantis to grow at the rate of 100% per year for two years.

210. Therefore, on January 19, 1976, a reasonably prudent investor would have assumed that financing in the amount of $24,000 would have to be lent to Atlantis in order for Atlantis to achieve the value of $96,410.

211. In valuing Atlantis' equity on the basis of the above assumptions, a reasonably prudent investor would have concluded that the capitalized earnings value of Atlantis was $72,410 as of January 19 1976. ($96,410 minus $24,000 additional capital.)

-45-

212. On January 19, 1976 a reasonably prudent investor would also have given weight to the fact that the assets had a zero net worth and that there was a distinct possibility that the corporation could fail.

213. Assigning no weight to the fair market value of the corporation's stock, since its value was unable to be determined as of January 19, 1976, and assigning equal weight to the net value of the corporation's assets and the capitalized value of the corporation's earnings, the Court finds that, as of January 19, 1976, Atlantis Development, Inc. had an equity value of $36,205.

214. There were substantially no barriers to entry for competition in this industry. It took very little to open such a business and compete with Atlantis with a similar product. The number of such competitors has doubled since January 19, 1976. In 1973, Atlantis was started with only $1,000 of capital. A reasonably prudent investor who wanted to get into the business would not have paid $550,000 for Atlantis when he could have started another company for much less money and competed with a comparable product.

215. Atlantis had developed a reputation for producing a high quality product, and a reasonably prudent investor would have paid more than $3,500 for Atlantis on January 19, 1976.

216. In concluding that Atlantis was viable as of January 19 1976, van Breda assumed that its four principals would be willing to work for Atlantis in 1976 for total compensation to the four of them amounting to only $11,000, an unreasonably low figure.

-46-

217. The financial statements of Atlantis Weathergear, Inc., without adjustments, showed the following history of operations:

Year	Gross Sales	Net Profit
1976	$ 386,827	$ 35,107
1977	917,705	84,004
1978	1,459,443	115,167
1979	2,039,226	117,538

218. Pursuant to the agreement among the shareholders of Atlantis Development (Plaintiffs' Exhibit 2.30), each shareholder would be entitled to a marketing commission of 1.5% of gross sales and to a profit incentives payment of 10% of net profits before taxes.

219. In addition, each shareholder would be entitled to a design royalty of 5% of gross sales, as well as a base pay.

XI. DEFENDANTS' COUNTERCLAIM

220. A few months after the January 19, 1976 stockholders and directors, an article appeared in the Washington Post regarding a scandal in the potato futures market. An individual by the name of John R. Simplot had defaulted in his obligation to make delivery of potatoes under the futures.

contracts, and this was the first time such a default had occurred in the commodity futures market. Simplot eventually was convicted in the Federal-Court of attempting unlawfully to influence the potato futures market. Malloy was not mentioned in the 'Washington Post article which reported the Simplot default.

221. Section 13 (b) of the Commodity Exchange Act, 7 U.S.C.A.

§1, et seq., provides as follows:

"It shall be a felony punishable by a fine of not more than $100,000 or imprisonment for not more than five years, or both... for any person to manipulate or attest to manipulate the price of any commodity in interstate commerce..."

222. Solomon read the Washington Post article in May of 1976. After reading the article, Solomon called Daniel Morgan, head of the national desk for the Washington Post. Solomon suggested or implied to Morgan that Malloy had been participating in a manipulation of the potato market.

223. Solomon knew that Malloy traded in potato futures. While sailing in May 1975, during the discussions concerning, Malloy's investment in Atlantis, Solomon had participated in a conversation with Malloy and a Stephen Greene about the potato futures market. Solomon did not then have reason to believe that the conversation was about any illegal activities. At the present time, he is not sure about this, but his suspicions are purely speculative.

224. Defendant Patrick E. Malloy was known to the public through the news media as a significant trader in the commodity futures market, especially with respect to potato futures. Ma Malloy traded in potato futures through Stephen Sundheimer and Pressner Trading Corporation at the time of the default.

- 48-

225. Stephen Sundheimer was an individual whom the Commodity Futures Trading Commission also investigated with respect to the default in the potato futures market.

226. Pressner Trading Corporation was a large corporation engaged in buying and selling for customers accounts potato futures contracts. It was also under investigation by the potato futures trading.

227. In his discussion with Morgan, Solomon gave Morgan Malloy's telephone number and the telephone number of Malloy's employer at E. F. Hutton. Morgan then telephoned Malloy several times.

228. Morgan started by asking Malloy general questions about potato futures and the potato futures market. When Morgan's questions started to become more personal and private, Malloy asked him why he was being asked these questions. Morgan then told Malloy that he had information that Malloy was participating in a manipulation of the potato market. When Malloy asked Morgan the source of his information, Morgan stated that it came from one Dennis Solomon. Malloy then explained to Morgan that Solomon was angry with Malloy over a

business dispute. When Morgan learned that he stopped calling Malloy.

229. In addition to calling Malloy, Morgan also called Malloy's former supervisor, David T. Johnston, director and

senior vice president at E. F. Hutton. Johnston held Malloy in "the highest esteem" from the time of his employment with that company throughout all the incidents referred to in the testimony. Malloy's reputation did suffer in the eyes of Mr. Johnston. (Defendants' Answer to Plaintiffs' Request for Admission of Fact.)

230. Solomon discussed this matter with "quite a few people" besides Morgan, one of whom was a Dr. Frank guest, director of a program sponsored by the Association of American Colleges in Washington, D.C.

231. Solomon never called, Malloy or Greene to seek clarification of-the May 1975 conversation he had overheard.

232. For at least a week or so, brokers who worked on the floor of two different commodity exchanges came up to Malloy and either questioned him about the Simplot default or made kidding remarks about it.

233. Wall Street is a community where reputations for honesty are important. To those floorbrokers whom Malloy knew as a friend or as a business associate Malloy would explain the situation in response to the above comments.

234. There were some floorbrokers who made snide remarks to Malloy about rumors that they had heard about his alleged involvement with the Simplot default.

235. Solomon presented no evidence at the hearing that would prove or tend to prove that Mallow ever engaged in any wrong, unlawful or manipulative practices in connection with potato futures or the potato futures market.

236. The telephone call from Morgan to Malloy and the questions and comments from other brokers caused Malloy some personal outrage and embarrassment for a period of time.

237. .There is no evidence that Malloy suffered any financial damages as a result of the'-actions of Dennis Solomon.

XII. SUBSEQUENT EMPLOYMENT OF SOLOMON

238. The employment contract (Plaintiffs' Exhibit 2.30) provides among other things, as follows:

"It is further agreed that in the event of termination by any or all of the persons Dean W. Meledones, Mark A.

Mordecai, and Dennis J. Solomon they will not compete with the business conducted by Atlantis in the marine mail order business nor in the design, marketing, or manufacturing of foul weather-gear for a period of five years from the date of termination of this contract."

239. In October of 1976, Solomon entered into a consulting contract with Peter Storm, a competitor of Atlantis. He designed a jacket for Peter Storm that competes with the business conducted by Atlantis.

240. Peter Storm then manufactured and sold that jacket in competition with Atlantis Weathergear.

241. Solomon also assisted Peter Storm in marketing some of its product by modeling for Peter Storm in its brochure.

-51-

242. Solomon also disclosed to Peter Storm design concepts and processes Solomon had developed for Atlantis

XIII. ATTORNEYS' FEES

243. Plaintiffs' attorneys in this cause seek an award of attorney’s fees in their capacity as representatives of the corporation and the stockholders in a derivative action

244. Plaintiffs' attorneys have worked a total of 901.5 hours in the trial and preparation of this case through May 21, 1480. The case is a complex one requiring a knowledge of financing, use of expert witnesses concerning valuations of companies, familiarity and understanding of extensive documents, and the taking of numerous depositions. Depositions were taken in San Francisco, California; Bridgeport, Connecticut, and Baltimore, Maryland.

245. In 1977, Plaintiffs' counsel charged $40 per hour, which the Court finds to be reasonable. Plaintiffs' counsel now charges $60 per hour or $55 per hour for bills paid within 30 days.

246. The Plaintiffs have incurred expenses of $10,978.75 in prosecuting this action

247. A substantial part of the Plaintiffs' counsel fee arrangement is on a contingent basis No evidence was presented to show how much of counsel's time and expenses went into the derivative action and how much went into the defense against Malloy's counterclaim.

248. The Court finds that attorneys' fees in the amount of $25,000 plus expenses of $7,500 is reasonable for the derivative action

- 52-

CONCLUSIONS OF LAW

1. Atlantis Development, Inc. was incorporated in Massachusetts. Its internal affairs are thus governed by the laws of that state. Rogers vs. Guaranty Trust Company, 288 U.S. 123, 130 (1933).

2. The Plaintiff-s contend that the notice given of the January 1976, meeting, of stockholders was inadequate because it was not stated in the notice that one of the purposes of the meeting was to consider the sale of the assets of the corporation. There is no question but that both the Massachusetts Statutes (M.G.L.A. c. 156B, §§36 and 75) and the by-laws of Atlantis Development Inc-(Plaintiffs' (Plaintiffs' Exhibit 1.02) required that written notice.-of the purpose of the meeting be liven prior to any stockholders meeting that was to consider and vote on a sale, of the. assets of the corporation Inasmuch as such purpose was not specified in the notice given prior to the meeting of January 19, 1976, the action taken at „that meeting -authorizing a sale of the assets to the Defendant, Patrick E. Malloy, invalid absent a waiver of the notice. requirement or a ratification or validation of-the action:- 18 C.J.S. Corporations, §545; M.G.L.A. c. 156B.

3. Although no written waiver. of notice was ever executed by any of the stockholders, either before or after the meeting of January 19, 1979, the Defendants claim that Plaintiffs Solomon and Melodeons waived

-53-

their right to notice by their participation at the January 19, 1976 meeting. All of the stockholders were present at the meeting, and none of them objected to the subject of the 'financial position of Atlantis being discussed or to the discussion of the sale of the assets to Malloy. When the question of the sale came up for vote, Solomon requested a ten-day delay. This request was rejected on the ground that it would be inconvenient to get all of the stockholders together again in ten days. Meledones requested a 24-hour delay. This request also was rejected. Both Solomon and Meledones participated in the discussion, and both voted when the issue was put to a vote, Meledones voting in favor of selling the assets of the corporation to Malloy and Solomon voting against the proposed sale. Neither Solomon nor Meledones ever voiced an objection to lack of notice during the course of the meeting. A general rule that has been widely accepted provides that when all the stockholders of a corporation are present or represented by proxy and participate in a meeting, they may take up and decide any matter even though the matter was not included in the notice, unless a stockholder objects at the meeting to the lack of notice. If a stockholder participates in the discussions and votes on the proposal he is bound by the vote, even though he voted against the proposal. Fletcher, in his treatise on corporations, says:

"It follows that if all the stockholders or members who are entitled to vote are present, the validity of a meeting is not affected by failure to give notice, or by defects or irregularities in giving notice, and if all are present and participate, they may transact business of a different character from that specified in the notice." Fletcher, Cyclopedia of Corporations, Chapter 13, Section 2011, p. 63. See also 19 Am Jur 2nd Corporations, Section 615; 64 ALR 3rd 358, 367-8. 3y

-54-

virtue of their presence at the meeting of January 19, 1976, their participation in the discussions relating to the sale of the assets of the corporation to Malloy, their failure to object to lack of notice, and their casting of their votes when the issue was put to a vote, Plaintiffs Solomon and Meledones waived any objection that they might have had to the inadequacy of notice

4. It is required by statute in Massachusetts that in order to sell "all or substantially all" of a corporation's assets there must first be a "vote of two-thirds of each class of stock outstanding and entitled to vote thereon..." (M.G.L. A. c. 156B §75.) There is no statutory requirement for a vote by the board of directors of a corporation in such case. A Corporation may wish to have its directors participate in a decision of this sort, however, and there is no prohibition against this. Plaintiffs claim that a valid two-thirds vote of the stockholders was not obtained prior to the sale to Malloy, and that the votes of none of the three stockholders who voted for the sale should, in fact, be counted

(a.) Malloy. It is claimed by the Plaintiffs that Malloy stood to gain by sale of the assets to him, that his interests were antagonistic to those of Atlantis Development, and that because of his self-interest in the transaction he was disqualified from voting. In a close corporation a director has a fiduciary duty under Massachusetts law not to vote on a proposal in which he is personally interested. American Discount Corporation v. Kaitz, 206 NE 2d 156 (Mass., 1965). To the extent that he acted as a director, Malloy should not have voted on the sale of the

corporation's assets to himself, and his vote as a director should not be counted. However, assuming Mordecai and Meledones to be qualified to vote, and assuming that a vote by the board of directors was desired, their votes would have been sufficient to pass the motion. American Discount Corporation v Kaitz, supra. Insofar as Malloy acted in his capacity as a stockholder, there is no automatic disqualification from his voting on a matter affecting his own self interest. Kentucky Package Store, Inc. v. Checani, 117 NE 2d 139 (Mass., 1954). In a close corporation, the guiding principle under `Massachusetts law is that the stockholders owe one another the fiduciary duty of "utmost good faith ands, loyalty". Wilkes v Springside Nursing home, Inc., 353 NE 2d 657 (Mass., 1976); Donahue v. Rodd Electrotype Co. of New England, Inc.,' 328 NE 2d 505 (:Mass., 1975). This duty is fulfilled, according to the Wilkes case, if the interested stockholder can demonstrate a legitimate business purpose for the action taken. The court must then "weigh the legitimate business purpose, if any, against the practicability of a less harmful alternative." (Supra, p. 663) Whether there was a legitimate business purpose that Justified Malloy's vote will be dealt with below. If there was such a purpose, then Malloy was qualified to vote, and his vote should be counted toward meeting the statutory two-thirds requirement. If Malloy should have been disqualified from voting because he was not "entitled to vote", then his 25% ownership interest should not be included in computing the number of votes needed to meet the two-thirds requirement. American Discount Corporation v. Kaitz,

supra. Excluding Malloy's vote, the votes of Mordecai and were still sufficient to meet the two-thirds requirement of the statute.

(b.) Mordecai. Plaintiffs claim that Mordecai stood in the same position as Malloy, that he stood to gain by becoming employed in Malloy's new corporation, and that this self-interest was enough to invalidate his vote, in accordance with the principles enunciated above. Plaintiffs bear the burden of proof on this allegation, but the evidence does not bear them out. None of the principals knew the true financial condition of the company prior to their coming to Vermont for the January 19, 1976 meeting. The seriousness of the condition was not discovered until the evening of January 18, 1976 when Malloy, Mordecai, Tim Davis and Buffi Robbins met to review the financial records. Meledones was invited to the meeting, but declined to attend. The gravity of the situation was

discussed, but no plan of action to deal with it was developed during the evening of January 18, 1976. The first mention of a sale of the assets to Malloy came at the shareholders' meeting on January 19, 1976, and this suggestion was made only after there had been considerable discussion of other alternative solutions. When the vote was finally taken to sell the assets to Malloy, it was agreed that Malloy would return the assets to the corporation if a better deal could be found within 90 days. There is no evidence of any conspiracy between Malloy and Mordecai for Malloy to take over the corporation and retain Mordecai on the payroll. Mordecai's vote should be allowed to stand.

-57-

(c.) Meledones. The Plaintiffs claim that Meledones' vote in favor of the sale was procured by fraud on the part of Mordecai and Malloy and that his vote should therefore be invalidated. Plaintiffs have the burden of proving fraud by "clear and evidence". Lincoln v. Emerson, 137 Vt. 301 (1979). The discussion at the meeting of January 19 centered around the deficit of about $30,000, the fact that substantial obligations would be due and payable shortly, and the fact that substantial additional capital would be needed in order to keep the corporation going. There was no evidence of any attempt by anyone to conceal information. The books and records were readily available to all and were, in fact, borrowed by Meledones after the meeting so that he could make an independent review. The fact that Alb had been extending credit for 90 days rather than the 30 days set forth in the written agreement, that the $20,000 letter of credit might not be able to be called for one more month, and the fact that Malloy's notes were not due till January 31, 1976, while reducing the need for an immediate decision, did not reduce the seriousness of the financial situation and did not change the fact that Atlantis could have continued in business for only a short period of time unless it could find substantial amounts of new capital within the very near future. Malloy and Mordecai may be criticized for failing to mention that the corporation had recently doubled its order of goods from Alb, but that increase was for a limited period of time only, and there is no evidence that it had any significant effect on the operations of either Atlantis or Weathergear. The

-58-

defendants deny any deliberate attempt to conceal or misrepresent facts, and there is no evidence of any attempt by Malloy or Mordecai to deliberately conceal or misrepresent pertinent information. Fraud may not be presumed. Lincoln v. Emerson, supra. In the absence of evidence of a scheme to defraud or evidence that the missing information had a significant effect on the corporation's operations, the Court is unable to find fraud on the part of the Defendants. The votes of Mordecai and Meledones must stand.

5. (a) Legitimate business purpose.

The Plaintiffs contend that the sale of the corporate assets to Malloy should be rescinded if for no other reason that it not serve a legitimate business purpose. In this regard, the burden of proof falls initially on the controlling stockholders (here, the Defendants) to demonstrate a legitimate business purpose, and once this is done, the minority stockholders (here, the Plaintiffs) would then have the burden of showing that the same legitimate objective could have been achieved through an alternative course of action less harmful to the interests of the minority. The Court must then weigh the practicability of the alternatives. Wilkes v. Springside Nursing Home, Inc., 353 NE 2d 657 (Mass., 1976). The evidence shows that on January 19, 1976 Atlantis was facing a deficit of approximately $30,000,*that the corporation's notes to Malloy in the amount of $45,000 would be due and payable on January 31, 1976, that the corporation needed substantial additional financing in order to continue

operations, and that no known means of financing was apparently available. Various solutions were discussed and rejected, including bankruptcy and the sale of stock. Given the discouraging financial picture confronting the stockholders on January 19, 1976, a decision to sell the assets would appear to be a

-59-

legitimate and reasonable alternative.

(b) Alternatives.

The Plaintiffs contend that the decision to sell the assets was made too precipitously, that the operation could have continued for a short period of time while the situation was studied and the books and records reviewed, and that the sale was made for inadequate consideration. The evidence shows that the idea to sell the assets was broached for the first time during the course of the meeting on January 19, that the corporation could have maintained a holding pattern for a least 10 days until the notes came due and for considerably longer if they were not called, and that the actual value of the corporation was considerably more than the $1 that was paid by Malloy for the assets. The burden is on the Defendants to demonstrate, among other things, that the purchase price was fair. Godley v. Crandall and Godley Co., 105 NE 818 (ICY. Ct. of App., 1914). They have failed to meet this burden. The finding of the Court indicate that the value of Atlantis on January 19, 1976 was $36,205. The sale for $1, thus, was for a grossly inadequate sum. Inadequacy of price alone, however, is not sufficient ground for granting relief. The inadequacy must be so gross as to "display itself as a badge of-fraud." `8 C.J.S. Corporations, §515, pp. 1198-9. In this case, there is too great a disparity between $1 and $36,205. The Plaintiffs' are entitled to relief.

6. Defendants contend that Plaintiffs are barred from recovery because they have not proved that they made any effort to have the action brought by the corporation or that such effort would have been futile. It is clear, however, that, where half of the stockholders and directors of the corporation are Defendants to the action and are alleged to have 18 C.J.S. Corporations,

-60-

perpetrated a fraud, any effort by the Plaintiffs to have the corporation itself bring suit would have been a futile gesture, and was thus unnecessary. Pupecki v. James.Madison Corp., 382 NE 2d 1030 (Mass., 1978). Nor are the Plaintiffs limited, under such circumstances, to the statutory remedy of having their shares appraised, as provided in M.G.L.A. c. 156E § 86 et seq. Pupecki v: James Madison Corp., supra.

7. Plaintiffs seek, among other things to be awarded a proportional ownership interest in Weathergear. This, however, would not be an equitable result but would, instead, unjustly enrich the Plaintiffs. Plaintiffs did not bring suit until one year after the vote to sell the assets. During this period of time Malloy invested substantial additional sums of his own money in the business. Both Malloy and Mordecai have expended considerable time and effort to expand and improve the business. New products have been added, and Malloy has acquired a majority ownership interest in the major supplier, Alb. The Court has not found conspiracy or actual fraud on the part of Defendants Malloy and Mordecai. Rather, the fault on their part lay in the unseemly and ill-advised haste. in the decision to sell and the sale for inadequate consideration, constructive fraud, in effect, not actual fraud. Proctor Trust Co. v. U Upper Valley Press Inc. 137 Vt. 346, 354 (1979). See also Papenfus v. Webb Products

Company, Inc. 24 Cal. App. 2d 559 (1938)) Old Metal Process v. United Engineering and Foundry Co., 107 Fed 27 (3d Cir. 1939). The Plaintiffs should be reimbursed for the valor of their ownership interest in the business immediately prior to the sale, but not to the extent of an ownership interest in the present business. The Court has found that as of the date of sale Atlantis Development had a value of $36,205. The Plaintiffs are each entitled to one-fourth of this amount, or $9,051.25, plus interest at the legal rate from and after January 19, 1976.

8. Plaintiffs are not entitled to punitive damages in the absence of proof of actual fraud on the part of the Defendants. Proctor Trust Co. v. Upper Valley Press, Inc. supra.

9. The debenture holders are entitled to no recovery, having accepted Malloy's offer and having received payment in accordance therewith. There is no evidence of fraud or coercion in connection with these transactions that would warrant rescinding them.

10. Solomon breached his employment contract by failing to perform the services specified therein. He spent the majority of his time working on his boat, rather than on the affairs of the corporation, and when sent on a sales trip, he chose to sail his boat and was late to each of the three boat shows he was supposed to cover, all to the detriment of the corporation. He is entitled to no compensation under the employment contract.

11. Meledones settled with the corporation, releasing his claims under the employment contract in exchange for the corporation's automobile. He performed no services for the corporation after signing the release, and he is entitled to no further compensation under the employment contract.

12. Plaintiffs are entitled to recover reasonable attorneys' fees on their stockholders' suit. They are entitled to recover the amount of $25,000 for attorney's fees plus expenses of $7,500.

13. Solomon, in making his unfounded telephone call to Morgan of the Washington Post, slandered Malloy in attempting to implicate him in the potato futures scandal. The conversation which Solomon overheard

-62-

between Malloy and Greene more than one year before was insufficient basis on which to form an opinion about illegal trading on the part of Malloy-in potato futures and insufficient reason to call an investigative reporter. Had he been interested in learning the truth, Solomon could have called Greene or Malloy. The Court can only conclude that, by calling Morgan, Solomon meant to embarrass and harass Malloy and that his motive was malicious. Malloy did suffer embarrassment and temporary injury to his reputation. He claims no monetary loss, but seeks and is entitled to compensatory and punitive damages for embarrassment, personal outrage and temporary injury to his reputation. Lancour v. Herald and Globe Association, 112 Vt. 471 (1942). Defendant Malloy shall be awarded judgment on his counterclaim against Solomon in the amount of $2,500 compensatory damages and $2,500 punitive damages.

14. Under the employment contract, there is a 5-year covenant not to compete with the business conducted by Atlantis Development, Inc., in the marine mail order business or in the design, marketing or manufacturing of foul weather gear. After the meeting of January 19, 1976, Solomon engaged in certain activities competitive with Atlantis Weathergear. Weathergear, however, was no Development, Inc., which was no reason for the Court to activities prohibited by the party to the employment contract, and Atlantis a party, is no longer in business. There

is enjoin Solomon from engaging in competitive employment contract.

Attorney for the Plaintiffs shall prepare a Judgment Order and submit it to the Court for signature.

Dated at Montpelier, Vermont this 23rd day of March, 1981.

END