



**PUBLIC (REDACTED) VERSION OF
REPORT OF THE SPECIAL LITIGATION COMMITTEES
OF THE
BOARDS OF DIRECTORS
OF
DARDANELLE TIMBER CO., INC.
AND
SUTHERLAND LUMBER-SOUTHWEST, INC.**

March 26, 2007

(Date of Redaction: April 10, 2007)

(PART 3 OF 3)

is considered relevant, *Hall v. Isaacs*, 146 A.2d 602 (Del. Ch. 1958), *aff'd in part*, 163 A.2d 288 (Del. 1960), as is the ability of the executive, the responsibilities he takes on, and the duties he performs. *Meiselman v. Eberstadt*, 170 A.2d 720, 722 (Del. Ch. 1961). “Other relevant factors are whether the salary bears a reasonable relation to the success of the corporation, the amount previously received as salary, whether increases in salary are geared to increases in the value of services rendered, and the amount of the challenged salary compared to other salaries paid by the employer.” *Wilderman v. Wilderman*, 315 A.2d 610, 615 (Del. Ch. 1974) (citing 2 Washington and Rothschild, COMPENSATING THE CORPORATE EXECUTIVE, 848-73 (3d. Ed. 1962)). An objective showing as to the fairness of the compensation amount may overcome deficiencies in process. *See Valeant Pharm. Int'l v. Jerney*, 2007 WL 704935, at *3 (Del. Ch.) (“The court’s finding that ICN’s management and board used an unfair process to authorize the bonuses does not end the court’s inquiry because it is possible that the pricing terms were so fair as to render the transaction entirely fair.”); *Oliver v. Boston Univ.*, 2006 WL 1065196, at *25 (Del. Ch.).

3. The Waste Standard.

Plaintiff contends in her Complaint that some of the actions and decisions she challenges, principally the defense of the Section 220 Action, constitute a waste of corporate assets. The standard under Delaware law for proving a claim of waste is an “extreme test,” which is “very rarely satisfied by a shareholder plaintiff.” *Steiner v. Meyerson*, 1995 WL 441999, at *1 (Del. Ch.). To substantiate her claim of waste, plaintiff must prove that the Individual Defendants “authorize[d] an exchange that is so

one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration.” *In re The Walt Disney Co. Deriv. Litig.*, 731 A.2d 342, 362 (Del. Ch. 1998) (quoting *Glazer v. Zapata Corp.*, 658 A.2d 176, 183 (Del. Ch. 1993)). Thus, in order to state a valid “claim for corporate waste, the complaint must allege particularized facts showing that the corporation, in essence, gave away assets for no consideration.” *Green v. Phillips*, 1996 WL 342093, at *5 (Del. Ch.).

4. Missouri Contract Law.

The employment contracts challenged by plaintiff expressly provide that they “shall be governed by and interpreted in accordance with the laws of the state of Missouri.” Because the employees, Perry and Todd, perform services for the Companies from offices in Kansas City, Missouri, a Delaware court assessing any claims based on the contracts likely would respect the choice of law provisions contained in them. *See Falcon Tankers, Inc. v. Litton Sys., Inc.*, 300 A.2d 231, 235 (Del. Super. Ct. 1972) (Delaware courts will respect contractual choice of law provisions if the selected jurisdiction has a material connection with the transactions).

Under Missouri law, “[t]he interpretation of a contract is a matter of law.” *Dean Machinery Co. v. Union Bank*, 106 S.W.3d 510, 520 (Mo. Ct. App. 2003). “The cardinal rule of contract interpretation is to ascertain the parties’ intentions and to give effect to that intention.” *Care Ctr. of Kansas City v. Horton*, 173 S.W.3d 353, 355 (Mo. Ct. App. 2005). “Intent is to be determined from the contract alone and not based on the extrinsic or parol evidence unless the contract is ambiguous.” *Id.* The parties’ intent is

also to be determined based on “the plain and ordinary meaning of the words in the contract” and the contract must be considered “as a whole.” *Nodaway Valley Bank v. E.L. Crawford Constr., Inc.*, 126 S.W.3d 820, 825 (Mo. Ct. App. 2004). In addition, “each term of a contract is construed to avoid rendering other terms meaningless.” *Dunn Indus. Group, Inc. v. City of Sugar Creek*, 112 S.W.3d 421, 428 (Mo. 2003). “In order to determine the intent of the parties, it is often necessary to consider not only the contract between the parties, but subsidiary agreements, the relationship of the parties, the subject matter of the contract, the facts and circumstances surrounding the execution of the contract, the practical construction the parties themselves have placed on the contract by their acts and deeds, and other external circumstances that cast light on the intent of the parties.” *Butler v. Mitchell-Hugeback, Inc.*, 895 S.W.2d 15, 21 (Mo. 1995) (en banc).

“A contract is only ambiguous, and in need of a court’s interpretation, if its terms are susceptible to honest and fair differences.” *State ex rel. Vincent v. Schneider*, 194 S.W.3d 853, 860 (Mo. 2006). “A contract is not ambiguous merely because the parties disagree as to its construction.” *Dunn Indus. Group*, 112 S.W.3d at 428-29. “[C]ourts are prohibited from creating ambiguities by distorting contractual language that may otherwise be reasonably interpreted.” *Care Ctr.*, 173 S.W.3d at 355.

5. Ripeness.

Under well-settled Delaware law, courts will not “exercise jurisdiction over cases in which a controversy has not yet matured to a point where judicial action is appropriate.” *Stroud v. Milliken* 552 A.2d 476, 480 (Del. 1989); *Bebchuk v. CA, Inc.*,

902 A.2d 737, 740 (Del. Ch. 2006) (when the facts are not yet in a “concrete and final form” there is a risk of an “improvident or premature decision”). An action is not ripe for adjudication “when it is contingent . . . [and requires] the occurrence of some future event before the action’s factual predicate is complete.” *Multi-Fineline Electronix, Inc. v. WBL Corp. Ltd.*, 2007 WL 431050, at *8 (Del. Ch.). “[W]hen the material facts are not static and litigation in the matter is not immediate and inevitable, a reviewing court should move with great caution and hesitancy and should normally close the courthouse doors to the litigants on the particular matter unless truly extraordinary and exigent circumstances are present.” *Id.*

The Court takes a “common sense approach” which requires it to “decide whether the interests of those who seek relief outweigh the interests of the court and of justice in postponing review until the question arises in some more concrete and final form.” *Bebchuk*, 902 A.2d at 740. In determining whether a given claim is ripe, “a practical evaluation of the legitimate interest of the plaintiff in a prompt resolution of the question presented and the hardship that further delay may threaten is a major concern. Other necessary considerations include the prospect of future factual development that might affect the determination to be made; the need to conserve scarce resources; and a due respect for identifiable policies of the law touching upon the subject matter of the dispute.” *In re Digex, Inc. S’holders Litig.*, 789 A.2d 1176, 1206 (Del. Ch. 2000).

Courts have found that claims were not ripe in a wide variety of circumstances. One instance involved a plaintiff who challenged a bylaw as illegal, and

the Court held that the claim was not ripe because the shareholders had not yet voted on whether to approve the bylaw. *See Bebhuk*, 902 A.2d 737. Another instance involved a plaintiff that brought a claim for injunctive relief to direct a company to vote against a proposal, and the Court held that the claim was not ripe because the complaint did not contain any facts that the company planned on voting for the proposal. *See Multi-Fineline*, 2007 WL 431050. Yet, another example involved a plaintiff that sought a declaration that certain aspects of its exchange offer were legal, and the Court held that the claims were not ripe because there was no exchange offer in place when the action was filed, nor at the time of the Court's decision.⁵⁰ *See CRI Insured Mortgage Ass'n, Inc. v. AIM Capital Mng't Corp.*, 1990 WL 212293 (Del. Ch.).

6. The Statute of Limitations.

A three-year statute of limitations applies to plaintiff's claims for breach of fiduciary duty and waste of corporate assets. *See In re Dean Witter P'ship Litig.*, 1998 WL 442456, at *3 (Del. Ch.), *aff'd*, 725 A.2d 441 (Del. 1999) (citing 10 *Del. C.* § 8106); 10 *Del. C.* § 8112 (three-year statute of limitations period for corporate waste claims). The statute of limitations begins to run at the time that the cause of action accrues, which

⁵⁰ To the extent plaintiff's Complaint seeks to assert a claim based upon Southwest's investment in SuthAir and the possible acquisition of a Mustang jet, the Special Committee concludes the claim is not ripe as no final decision has been made to acquire that jet. Moreover, given the current state of orders for the new Mustang, it appears the owners of SuthAir may have an opportunity to sell SuthAir to another party interested in that aircraft.

is generally when there has been a harmful act by a defendant. *See In re Tyson Foods, Inc.*, 2007 WL 416132, at *12 (Del. Ch.).

The limitations period may be tolled, however, when the plaintiff, due to no fault of her own, is unaware of the facts giving rise to the claim. *See In re Dean Witter*, 1998 WL 42456, at *3. The statute of limitations period may be tolled under three tolling theories: (1) inherently unknowable injuries; (2) equitable tolling; and (3) fraudulent concealment. *See In re Tyson*, 2007 WL 416132, at *3. Under any of these theories, the party seeking to toll the limitations period “bears the burden of pleading specific facts to demonstrate that the facts were so hidden that a reasonable plaintiff could not have made timely discovery of an injury necessary to file a complaint within the statute of limitations.” *Smith v. McGee*, 2006 WL 3000363, at *3 (Del. Ch.). The limitations period is only tolled “‘until the plaintiff discovers (or exercising reasonable diligence should have discovered) his injury’ – that is to say, until plaintiff is on inquiry notice.” *Id.* (quoting *In re Dean Witter*, 1998 WL 442456, at *6). A plaintiff is considered on inquiry notice if he “is in possession of facts sufficient to make him suspicious, or that ought to make him suspicious.” *Id.* (quotations omitted); *see also In re Tyson*, 2007 WL 416132, at *12 (plaintiff is on inquiry notice when he “was objectively aware, or should have been aware, of facts giving rise to the wrong”).

With respect to plaintiff’s many claims of self-dealing and improper personal benefit, including with respect to use of the Aircraft and Cimarron work for Choctaw prior to Dwight Sr.’s death in October 2003, the Special Committee observes

that, given plaintiff's misapprehensions concerning systemic self-dealing at the Companies dating back to the 1990s, including specific knowledge concerning the ownership and use of the Companies' aircraft (*see supra* § II.B), and the likelihood that the delay in asserting such claims was in deference to Dwight Sr. and not a lack of inquiry notice, the Individual Defendants would have a substantial argument that claims based upon events occurring before September 6, 2003 would be barred by the statute of limitations. The Individual Defendants would also assert with some factual support that many of the expenses incurred before Dwight Sr.'s death were at his direction and that all of the stockholders of Dardanelle tacitly acquiesced in them.⁵¹

As to the fixed fee estimates charged to Choctaw prior to 2004, moreover, the Special Committee concludes that these estimates were made by professionals at Cimarron, not by Perry, Todd, or Mark. The Special Committee also notes, with respect to the provision of accounting services by Cimarron before November 2003 that it is not practical, based on the existing documentary record, to determine precisely to what extent Choctaw and other entities may have received a benefit that was subsidized by the Companies. Based on the available record, however (including the fact that actual Cimarron charges to Choctaw for August 1, 2003 through July 31, 2004 of \$7,948 only exceeded minimally the \$7,500 fixed fee billed to Choctaw in the previous year), it

⁵¹ *See Frank v. Wilson & Co.*, 32 A.2d 277, 283 (Del. 1943) (noting that defenses of laches, acquiescence and ratification are related and that acquiescence "speaks of assent by words or conduct").

appears that the total value of any such benefit would not be material. Accordingly, the Special Committee concludes that further pursuit of such pre-September 2003 accounting services claims would not be in the Companies' interests on any rational risk/reward analysis. Notwithstanding the strength of the statute of limitations defense, however, the Special Committee has analyzed other significant claims and events occurring before September 6, 2003 and has not relied solely upon the probable availability of the statute of limitations defense in reaching any of its determinations.

B. Analysis Of Plaintiff's Challenge To Compensation
And Perquisites Of Perry And Todd.

Based upon its investigation, the Special Committee is satisfied that Perry devotes the equivalent of full time to his work at Dardanelle and Southwest. Based upon interviews with Perry and other employees of both Southwest and Cimarron, and a review of his calendars, it appears that Perry is normally in the office from approximately 7:30 a.m. to 4:00 p.m. on weekdays, with additional time on Saturdays. In addition, he devotes some Sundays to company business (*e.g.*, five Sundays in 2006), and rides circuit to the Companies' ten stores every one and one-half months. Weighted against this, he spends approximately forty business days on vacations and non-Company business. However, these periods are relatively short in duration and he habitually stays in contact with the Company even during those periods.

Perhaps as significant as the time spent on the job is the level of responsibility assumed by Perry at the Companies. There currently is only one district manager (one district manager passed away in October 2005 and another retired in

September 2003, but neither has been replaced as Perry has assumed their duties) and the ten store managers generally report directly to him.⁵² In addition to being the only employee responsible for strategic planning and decisions to acquire or dispose of stores, he hires and fires the top three persons at each store, establishes salary levels for all of the Companies' four hundred full-time employees, handles all equipment purchases and reviews every order over \$1,000. In short, viewing the entire picture, Perry is a fully-engaged executive whose role at the Companies cannot fairly be characterized as "part-time."

Todd Sutherland, who holds the offices of vice president and corporate secretary, is not a full-time employee of the Companies and does not maintain an office in the Companies' headquarters. He has estimated that he spends 150-200 hours each year on the Companies' business as a part-time employee. In that regard, and given his background as a banker, he consults regularly with Perry on matters such as lending relationships, the structure of debt, and decisions whether to purchase versus lease at new store locations. In particular, he assisted in the negotiation of the purchase of the El Campo store and was also involved in decisions with respect to the financing of the Marble Falls acquisition. As the only family member other than Perry active in the

⁵² Based on its review of the documentary record, the Special Committee concludes that the remaining district manager, in 2006, had gross pay in excess of \$122,000, with the other district managers earning more than \$100,000 when they were full-time employees. The Companies also employ a buyer who earned more than \$85,000 in 2006, and employ several store managers who earned approximately \$80,000 in 2006.

business, he tries to keep sufficient contact with the details of the Companies' business so as to permit him to step in on an interim basis were Perry to die or become disabled. For that reason, in two of the past three years he has visited stores with Perry for purposes of conducting inventory and to maintain familiarity with company personnel.

The Special Committee concludes, based upon its review of the documentary record and interviews of persons with first-hand knowledge, that the process by which the terms of Perry's compensation was determined was largely derived from what their father had approved and application of "past practices" in the family. In all events, and even without the benefit of compensation advice not normally sought in the private company context, the \$200,000 base salary paid to Perry as the only corporate level executive in a company with almost \$70 million in sales would not, as a matter of common sense, require a formal process to approve it.⁵³ The Companies have long been family-run businesses, and have not had in place the independent compensation committee structure to which Delaware law looks as evidence of procedural fairness in public corporations. Although there were no negotiations of the terms of the employment agreements, the Special Committee concludes that the agreements' terms were intended, in good faith, to memorialize what had been years' long practice at the Companies.

⁵³ Perry's \$200,000 base salary, which has not changed since 2002, is the same amount paid to Dwight Sr. in 1981. During the interview by the Special Committee, Dwight Jr., Martha and her counsel indicated that their concern was not so much with the base compensation as it was that Perry may be receiving excessive perquisites at the expense of the Companies.

To assist it in assessing the objective fairness of the total compensation received by Perry, as part of its entire fairness assessment, the Special Committee engaged the services of RSM McGladrey, Inc. (“McGladrey”). McGladrey performed a Compensation Market Assessment of Perry’s compensation package from the Companies, including a review of published survey sources and a market review from public proxy statements. In its market data overview, McGladrey concluded that the median base salary for an executive at Perry’s level in a corporation with total sales comparable to those of the Companies was \$344,900. The median total cash compensation was \$394,200 and the median total direct compensation was \$493,700. From its analysis of proxy peer group market data, McGladrey concluded that the median base salary is \$261,000, the median total cash compensation is \$365,000, and the median total direct compensation is \$528,600. Based on McGladrey’s written and oral advice, the Special Committee concludes that a similarly situated executive for a comparable company would earn total cash compensation of approximately \$380,000 in today’s market, with some possibility of additional long-term incentive compensation.

As previously described in substantial detail, *see* § III.A.3, *supra*, the historical value of the Maysville perquisite has been *de minimis* for both Perry and Todd. Similarly, although the benefit of the tax and accounting services to Perry and Todd has been larger than the value of the Maysville perquisite, the total increase in compensation to each of Perry and Todd as a result of that perquisite is not material. Finally, the Special Committee concludes that the benefit from use of the Aircraft before the

amendment to Perry's employment agreements, when added to his base salary and the value of his other perquisites, is objectively fair.⁵⁴ With the change in his employment agreements, Perry is obligated to pay the expense of personal use of the Aircraft rather than having it added to his compensation at the SIFL rate.⁵⁵

To summarize, the base compensation for Perry, plus the fringe benefits authorized in paragraph 6 of his employment agreement, for each of the past three fiscal years was:

	Base Salary	Cimarron	Maysville	Aircraft	Total
August 1, 2003 - July 31, 2004	\$200,000	\$7,387	0	\$17,432	\$224,819
August 1, 2004 – July 31, 2005	\$200,000	\$12,506	0	\$7,715	\$220,221
August 1, 2005 – July 31, 2006	\$200,000	\$12,615	0	0	\$212,615

Perry's total compensation for these periods, even after considering the tax gross-ups in 2003 and 2004, is well below the \$380,000 total cash compensation amount in today's

⁵⁴ For the period August 1, 2003 through July 31, 2004, the Companies paid to Home Center a total of \$17,431.97 for invoiced personal flights by Perry. In the period August 1, 2004 through the time the law was changed, the Companies paid to Home Center \$7,715.09 for invoiced personal flights by Perry.

⁵⁵ The Special Committee has determined that in 2002, Perry received SIFL compensation of \$7,605.84, which was grossed-up for tax purposes to \$11,782.87. Dwight Sr.'s SIFL compensation in calendar year 2002 was \$8,479.44, grossed-up to \$14,532.04. In calendar year 2003, Perry received SIFL compensation of \$13,142.78, which was grossed-up for tax purposes to \$25,010.06, and Dwight Sr. received SIFL compensation of \$9,099.18, which was grossed-up to \$19,631.46.

market ascertained by reference to McGladrey. After “deflating” the total cash compensation benchmarks for prior years (based on information provided by McGladrey), the Special Committee concludes that Perry’s total cash compensation was objectively reasonable, and entirely fair to the Companies.

Todd’s base compensation, plus fringe benefits authorized in paragraph 6 of his employment agreement, for each of the past three fiscal years was:

	Base Salary	Cimarron	Maysville	Total
August 1, 2003 - July 31, 2004	\$14,760	\$6,359	\$1,900	\$23,019
August 1, 2004 – July 31, 2005	\$14,760	\$6,041	\$360	\$21,161
August 1, 2005 – July 31, 2006	\$14,760	\$10,399	0	\$25,159

Even taking the low end of the estimate by Todd of 150 hours per year on Dardanelle business, his compensation is less than \$170 per hour, which appears fair to the Special Committee given Todd’s financial background and the fact that he is the only other family-member executive familiar with the Companies’ affairs and able to step in on an interim basis should Perry be unable at some future point to perform his duties.

Notwithstanding that the process by which Perry’s compensation was determined was not robust, the Special Committee concludes, even considering the value of all of Perry’s fringe benefits (and noting the absence of any long-term incentive plan), that his total cash compensation is so significantly below that of similarly situated

executives such that it renders his compensation entirely fair. *See Valeant*, 2007 WL 704935 at *13. The Special Committee similarly concludes that Todd's total compensation from the Companies is entirely fair.

C. Analysis Of Plaintiff's Assertions That Southwest's Acquisition And Continued Ownership Of The Aircraft Constitutes A Breach Of Fiduciary Duty.

As noted in Section III.A.2, Southwest's 50% interest in the Aircraft was purchased in September 2001. For the reasons also reviewed in detail earlier in this Report, the Special Committee concludes that the Individual Defendants would have a particularly strong statute of limitations defense and possibly an acquiescence defense with respect to this business decision. That said, the Special Committee has also looked closely at the merits of the business decision to purchase and hold the 50% interest in the Aircraft and has concluded that such ownership constitutes a reasonable business expense which would likely be protected by business judgment rule principles.

Among the factors which the Special Committee considered in reaching that conclusion are the facts that: (i) Southwest has minimized its expense by owning only 50% of the Aircraft, and further reducing costs through its time-share relationships;⁵⁶

⁵⁶ The fact that the Aircraft is based in Tulsa, rather than Kansas City, requiring some "deadhead" expense in the use of the plane, is a by-product of this ownership arrangement and the fact that Home Center is based in Tulsa. Deadhead costs are far outweighed by the savings from owning only half the Aircraft and Home Center's uncompensated assumption of the responsibility for overseeing the Aircraft's operation, including scheduling, billing and other functions.

(ii) the need for efficient air transportation for business purposes is apparent given the relatively remote and geographically diverse locations of most of the Companies' stores; (iii) the Companies' business usage of the Aircraft, on a mileage basis, exceeds that of Dwight Sr., Norma, Perry, Todd and Choctaw in the aggregate; (iv) the cost of invoiced travel is dictated by federal regulation; (v) the average negative cash flow to Southwest over the past five years to own the Aircraft, in excess of invoiced amounts for travel, is approximately \$38,000; (vi) the reported depreciation on the Aircraft represents an opportunity for tax deferrals; and (vii) if the recent \$1.55 million appraised value (of a 50% interest) in the Aircraft is accurate, and as was the case with the Lear Jet, were the Aircraft to be sold, Southwest would likely recover a substantial portion of its initial \$1.9 million investment, less the carrying cost of the investment.

Considering all of the factors discussed in this section, the Special Committee has concluded that it is significantly more likely that plaintiff would not succeed on a claim challenging ownership of the Aircraft as either a breach of fiduciary duty or waste.

D. Analysis Of Plaintiff's Challenge To The Defense Of
The Section 220 Action.

Plaintiff alleges that Perry, Todd, and Mark caused the Companies to incur "enormous legal fees and related costs" to defend the Section 220 Action and that this constituted a waste of corporate assets because the Companies did not receive any benefit in return. Complaint ¶ 106. Specifically, plaintiff alleges that the Companies spent over \$700,000 defending the Section 220 Action "for the sole purpose of maintaining Perry's

and Todd's lavish lifestyles." *Id.* ¶ 107. Plaintiff further alleges that Perry, Todd, and Mark acted in bad faith and breached their fiduciary duties by causing the Companies to waste substantial sums defending the Section 220 Action "in order to conceal the corporate malfeasance for which [plaintiff] seeks redress." *Id.* ¶ 112.

1. Plaintiff's Section 220 Waste Claim.

While a claim for the waste of corporate assets can arise in a wide array of situations, including, among others, financing transactions, mergers, acquisitions, and compensation of executives,⁵⁷ the Special Committee, having consulted with counsel, is not aware of any instances where a waste claim was brought alleging that a party had committed waste by too vigorously defending a lawsuit and incurring unnecessary

⁵⁷ For example, in *Glazer v. Zapata Corp.*, plaintiff alleged that the defendants wasted corporate assets when they entered into a financing arrangement whereby an outside investor would receive several debt instruments with high rates of interest along with preferred stock and common stock of defendant in exchange for cash. 658 A.2d at 182. The Court rejected plaintiff's allegations because plaintiff only alleged that the defendants might have been able to find an arrangement with more attractive terms and thus was just challenging the business judgment of the board of directors in entering into the financing arrangement. *Id.*

In *Steiner v. Meyerson*, plaintiff alleged that the acquisition of another corporation by one of the defendants constituted a waste of corporate assets. 1995 WL 441999, at *5. Specifically, plaintiff alleged that the corporation gained nothing by increasing its ownership from 15% to 100% in the target corporation because the corporation allegedly already had the rights to the target corporation's technology when it owned 15%. *See id.* The Court rejected this argument and found that by increasing its ownership, the corporation did derive a benefit from the transaction because it increased its ability to share in the profits derived from the technology, as well as gaining complete control over the development, manufacturing, and marketing of the technology. *See id.*

expenses, a fact which itself suggests that such a claim may not be viable as a matter of law. What does appear clear, however, is that the concept of waste is not measured with the benefit of hindsight not available when an expense is authorized. In *Ash v. McCall*, for example, plaintiff claimed that the defendants had committed waste by purchasing a corporation that the “marketplace [was] basically valuing [] as zero” after the transaction. 2000 WL 1370341, at *8 (Del. Ch.). The Court rejected plaintiff’s argument and held that even if the transaction “turned out horribly” for the defendants, it still would not constitute waste. *Id.* The Court stated that even though the transaction might have turned out badly, it does not “mean that the approval of the merger was an act of corporate waste *at the time* the [] board entered into it.” *Id.* (emphasis in original).

In the present case, plaintiff claims that Dardanelle did not need to defend the Section 220 Action or should not have so vigorously defended the Section 220 Action (thereby incurring fees and expenses in excess of \$700,000) because she had a proper purpose in seeking inspection of certain books and records, and by causing Dardanelle to do so, the Individual Defendants committed waste. However, at the time they decided to defend the Section 220 Action and over the course of the litigation, the Individual Defendants could not know what the outcome of the Section 220 Action would be and spent what they believed, based on the facts and circumstances that were present, was necessary to defend it. Although the Court ultimately concluded that plaintiff did have a proper purpose and allowed an inspection of certain of the documents sought by plaintiff, Dardanelle and its counsel were not in a position to know that result until the Court of

Chancery rendered its final decision, which in all events resulted in some benefit insofar as the scope of the documents that were ordered to be produced was narrower than that sought by plaintiff.

In *In re Walt Disney Co. Deriv. Litig.*, plaintiff alleged that the nominal defendant's board of directors' approval of an employment agreement with an executive constituted waste. 731 A.2d at 362. In particular, plaintiff alleged that the employment agreement was structured to provide the executive a disincentive to remain at the corporation. *See id.* The Court rejected plaintiff's allegations and found that the employment agreement, while generous, was not "so one-sided that no businessperson of ordinary, sound judgment could conclude that [the defendant] received adequate consideration." *Id.* at 363. Here, the Special Committee believes that, without the benefit of hindsight, a reasonable businessperson could conclude that the Section 220 litigation had a sufficient prospect of full or partial success as to merit defending it, such that no waste claim lies. *See Saxe v. Brady*, 184 A.2d 602, 610 (Del. Ch. 1962) ("If it can be said that ordinary businessmen might differ on the sufficiency of the terms, then the court must validate the transaction.").

In all events, a partial benefit was achieved by limiting the scope of the production the Companies were ordered to provide to plaintiff. Upon its review of the record, the Special Committee also observes that much of the expense appears to have been the result of the need to respond to discovery initiated by plaintiff and the duplication resulting from the initial assignment of the case to a master. Furthermore, the

discovery taken in the Section 220 Action was somewhat broader than other Section 220 cases because the defendant challenged the validity of plaintiff's stated purpose in seeking the books and records, in addition to challenging that plaintiff had sufficient evidence to demonstrate a credible basis to infer mismanagement took place at the Companies. The Special Committee also notes that, while the total amount expended was large, an examination of the hours spent on each phase of the litigation does not appear to have been excessive. In short, the Special Committee concludes that plaintiff would be highly unlikely to convince a court that no reasonable person could have concluded to expend the funds paid in defense of the Section 220 Action, such that plaintiff's novel waste claim would fail.

2. Breach of Fiduciary Duty Claim.

Based on its interviews with the persons involved, the Special Committee finds that the Companies' officers who directed the litigation, Perry, Todd, and Mark, believed in good faith that production of all the documents sought by plaintiff was not in the Companies' best interest and that plaintiff had ulterior motives, a position that was not frivolous but which was not accepted by the Court.

The Special Committee's investigation, including interviews of the Individual Defendants and the Companies' counsel in the Section 220 Action, revealed that there was a belief that plaintiff's demand for inspection was for personal and vexatious purposes. The Individual Defendants and the Companies' counsel believed plaintiff had an ulterior motive in seeking the books and records primarily because of the

timing of her request, which was shortly after Dwight Sr.'s death and just after she was informed by her mother that her mother did not intend to hire a lawyer to help her alter her estate plan, and because she simultaneously made books and records demands on other Sutherland entities.⁵⁸ The Special Committee has not found any facts that would evidence that Perry, Todd, or Mark had a dishonest purpose in causing the Companies to defend the Section 220 Action or that they were seeking to conceal wrongdoing on their part.

The Special Committee's investigation also revealed that before deciding to defend the Section 220 Action, the Individual Defendants and Dardanelle's counsel engaged in costs-benefits discussions concerning whether it was prudent to defend the Section 220 Action. Throughout the litigation, the Individual Defendants and the Companies' counsel revisited the costs and benefits of defending the Section 220 Action and decided to continue with the defense. Further evidence that the Individual Defendants were not acting in bad faith or seeking to conceal wrongdoing on their part is that they chose not to appeal Vice Chancellor Lamb's decision granting plaintiff access to certain books and records to the Delaware Supreme Court.

⁵⁸ In addition to questions regarding the timing of plaintiff's demand to inspect the Companies' books and records, the discovery record in the Section 220 Action included documents and testimony that were consistent with the Individual Defendants' suspicions of plaintiff's purposes. For example, Dwight Jr.'s son referred to the dispute as "a private feud" and opined that "the Trust (and trusteeship), and not previous grievances against Perry, are the chief impetus for this litigation." Similarly, in her deposition, Martha indicated that she would not rest until she saw "Perry doing the perp walk a la Ken Lay."

In conclusion, the Special Committee did not find any evidence that Perry, Todd, or Mark were acting disloyally or in bad faith by causing the Companies to defend the Section 220 Action and concludes that plaintiff would be unlikely to prevail on her breach of fiduciary duty claim with respect to the Section 220 defense.

E. Analysis Of Plaintiff's Challenge To The Terms of the Employment Agreements.

The Special Committee, based upon its investigation, and for reasons previously discussed, has concluded that, since the employment agreements were adopted on February 21, 2004, there has been no abuse by Perry or Todd of the fringe benefits granted to them in paragraph 6 of their respective agreements. Moreover, the total compensation each of Perry and Todd has received, including the fringe benefits, is fair to the Companies. *See supra* § IV.B.

Plaintiff's Complaint, however, also appears to challenge the breadth of the terms of paragraph 6 of the employment agreements and the terms that would permit Perry and Todd to compete with the Companies or require that the Companies pay them severance benefits even if they were terminated for criminal or fraudulent conduct. *See* Complaint ¶ 48. In light of the Special Committee's conclusion that the perquisites provisions have not been abused in the past, and given its conclusion that neither Perry nor Todd is currently competing or intends to compete with the Companies, as well as the absence of any intention by the Companies to terminate their employment (for cause or otherwise), the Special Committee determines that such prospective claims, which depend upon the occurrence of events that have not occurred and may never occur, are

not ripe for adjudication. *See Bebhuk*, 902 A.2d at 740; *Multi-Fineline Electronix*, 2007 WL 431050, at *8. Accordingly, the Special Committee determines that such claims should be dismissed.

Notwithstanding the fact that these claims are not ripe and should be dismissed, the Special Committee concludes that good corporate governance suggests that modifications to the employment agreements, including clarification that the Companies' payments for tax and accounting work to be performed by Cimarron for Perry and Todd shall be limited to the preparation of individual tax returns for them and their immediate families, elimination of the right to compete with the Companies, and the adoption of an appropriate "for cause" carve-out to the severance benefits, should be negotiated between the Companies and Perry and Todd. Mr. Jeffrey therefore intends promptly to bring such proposed modifications to the attention of the full Board of Directors of each of the Companies for consideration.

F. Analysis Of The Complaint's Miscellaneous Claims.

As noted, the Complaint alleges that a variety of extravagant personal expenses have been charged to the Companies, challenges certain loans between the Companies and Perry or Todd, challenges a charitable contribution made by the Companies, and challenges certain changes made to the Companies' certificates of incorporation. In connection with an interview by the Special Committee, plaintiff and Dwight Jr. supplemented the allegations of the Complaint with specific claims of wrongdoing that they encouraged the Special Committee to investigate. To the extent not

already discussed and evaluated, the Special Committee addresses such claims and concerns, *seriatim*, below.

1. Charges of Extravagant Personal Expenses.

Paragraph 64 of the Complaint alleges a “myriad of personal extravagances at company expense.” Plaintiff and Dwight Jr. supplemented this allegation of the Complaint during an interview by the Special Committee.⁵⁹

a. Trains and automobiles.

Plaintiff and Dwight Jr. charge that Perry and Todd have improperly used rental cars, expensive hotels and limousines, specifically identifying Carey Limousine, London Town Car and the Lowell Hotel in New York City, for personal purposes at the Companies’ expense.⁶⁰ They suggested that Perry seeks reimbursement from the Companies for mileage he incurs on rented vehicles (a position reiterated in plaintiff’s counsel’s March 13, 2007 letter), and plaintiff identified a memorial service for Dwight

⁵⁹ Neither plaintiff nor Dwight Jr. could identify any of the “private parties” referenced in the Complaint.

⁶⁰ By letter dated March 13, 2007, counsel for plaintiff stated that there is on the “May 2004 bill from Perry’s corporate American Express card (DARD00328) a \$398.24 expense for a hotel in St. Louis. That expense is not marked ‘personal,’ and we infer that the expense was paid for by the companies.” Remarkably, plaintiff has apparently ignored the prior page, DARD00327, demonstrating that Perry sought reimbursement *not* for the hotel in St. Louis, but for two-thirds of a satellite cell phone bill. The Special Committee’s investigation revealed that Perry decided to take a phone on his personal vacation to Petit St. Vincent so he could be available for company business, but did not seek reimbursement of the full amount. Nor did he seek to be reimbursed for a charge on his personal credit card for his stay at a hotel in St. Louis.

Sr. held in Oklahoma during which Perry allegedly caused Southwest credit cards to be used for personal purposes (van rentals) and indicated that she personally paid for the van her immediate family used in connection with the memorial service.

The Special Committee's investigation revealed that Perry has used the services of Carey International in New York City on two occasions, March 27 and 29, 2005, and that he stayed at the Lowell Hotel during that time, all for the purpose of attending plaintiff's deposition in New York in connection with the Section 220 Action. There was no documentary or other evidence to support a finding that the Companies have an "account" with the Lowell Hotel, and no indication that London Town Car had been used, let alone at company expense. The Special Committee concludes, therefore, that there is no evidence of wrongdoing with respect to such matters.

As to the charge that Perry submits mileage for rental vehicles to be reimbursed by the Companies, plaintiff's counsel stated in a March 13, 2007 letter that he was enclosing "documents relating to Perry's attempts to obtain mileage reimbursements for rental cars, a practice that is not only facially inappropriate but also demonstrates a mindset that would lead him to commit the myriad of other wrongdoing alleged in the Complaint." The Special Committee already had reviewed the enclosed documents, which it concludes do not support the charge of wrongdoing, and its investigation found no other evidence substantiating such a claim. The Special Committee has concluded that Perry had business mileage on his personal vehicle reimbursed by the Companies for the years 2001 through 2006 as follows: 1,232 miles (approximately one-third of which

related to a trip to Wichita, Kansas) in 2001; 486 miles in 2002; 380 miles in 2003; 460 miles in 2004; 685 miles in 2005; and 420 miles in 2006. Most of this mileage relates to trips in Perry's personal vehicle from his home (and in other instances, the office) to or from the airport when he flies on the Aircraft for business purposes.⁶¹ Mileage for Perry is tracked by his assistant on a form indicating the Date, Days Out of Office, Location, Miles Accrued, and Company (which is indicated by a numeric code, 2401 and 3101 in the case of the Companies). By way of example, on September 23, 2003, Perry traveled to the Marble Falls and Del Rio store locations and the twenty miles on his personal vehicle to travel to the airport were allocated with one entry to Southwest. The next month, on October 17 and 18, 2003, Perry visited the Carlsbad, New Mexico, Sierra Vista, Arizona, and Bay City, Texas stores, and ten miles was allocated to each of Southwest and Dardanelle.

The Special Committee also has determined that the Complaint's allegation that Perry and Todd chartered private railroad cars at company expense is unfounded. The train trips in question occurred in 1998 and 2002 and were chartered through Northern Sky Rail Charter ("Northern Sky"). In both instances, Todd paid Northern Sky for the trips and was reimbursed by Perry and Dwight Sr. for their portion of the expenses. Based on its review of the documentary record, including canceled personal

⁶¹ Plaintiff's suspicion may relate to the fact that various stores are listed as the "location" on the mileage reimbursement forms. This entry does not reference the location where the vehicle was driven but is for the purpose of accounting for the location to which the mileage should be allocated.

checks, the Special Committee has concluded that Todd personally paid \$12,443 on April 17, 1998 and \$18,442 on May 15, 1998 to Northern Sky for the 1998 train trip. Perry reimbursed Todd \$6,000 on May 5, 1998 and \$6,295 on June 15, 1998 from his personal checking account, and Dwight Sr. reimbursed Todd \$6,295 by personal check dated June 8, 1998. With regard to the 2002 trip, Todd paid Northern Sky \$22,861 on April 16, 2002 and \$22,560 on May 1, 2002. Based on its investigation, the Special Committee concludes that Dwight Sr. agreed to pay one-half the expenses of the trip, and that Perry reimbursed Todd \$11,250 by personal check dated May 20, 2002.

With respect to plaintiff's allegations regarding van rentals during a memorial service for her father in Oklahoma, the Special Committee has concluded that plaintiff was referring to the "Hanging of the Hat" ceremony for Dwight Sr. in Oklahoma City, Oklahoma at the National Cowboy Hall of Fame. Vans were rented through Avis, and the family dined at the Ranch Steakhouse. These charges were incurred on Southwest credit cards, but reimbursed to Southwest by checks drawn on the account of the Norma H. Sutherland Revocable Trust. The documentary record also demonstrates that Norma's trust paid for the airfare of both Norma and Martha and her immediate family to fly to Oklahoma City. Perry personally paid the airfare charges for his family to attend the ceremony. In short, there is no evidence that the Companies paid any portion of the expenses incurred in connection with the memorial service for Dwight Sr.

b. The River Club and Perry's new house.

Plaintiff and Dwight Jr. also suggested that Perry had caused the Companies possibly to pay for his personal membership at The River Club in Kansas City, and that he had caused the Companies to pay some or all of the expenses he incurred in connection with the construction of his private residence.

The Special Committee has reviewed invoices from The River Club to Perry for December 2000 through January 2007 for expenses including annual dues, periodic board assessments, periodic renovation assessments, yearly Christmas bonuses to the staff, funds for the retirement of an employee, and expenses for food and beverage. The Special Committee also reviewed copies of checks from Perry to The River Club covering the expenses listed in those invoices. Based on its review of these documents, the Special Committee concludes that Perry, and not the Companies, has paid his expenses associated with his membership in The River Club.

The only evidence that the Special Committee uncovered of either of the Companies paying for expenses Perry incurred through his membership in The River Club are copies of an invoice for December 2000 and Perry's personal check dated January 16, 2001 to The River Club covering those expenses. On the invoice is a handwritten note to charge Dardanelle for the lunch at The River Club on December 6, 2000 in the amount of \$85. The lunch included Perry, Douglas R. Dagleish of Lathrop & Gage L.C., and Dave Preston. The purpose for the lunch was to "discuss [the] Boylan case and mediation." The Special Committee did not find evidence that Dardanelle was

in fact charged for the lunch on December 6, 2000, which in all events appears to have been for company business.

As to the claim that the Companies subsidized the construction of Perry's personal residence, the Special Committee concludes that Perry purchased certain construction materials at cost from Cimarron in 1999-2000, a benefit generally available to the members of the Sutherland family, which in all events did not constitute self-dealing as there was no detriment to either Cimarron or the Companies.

c. Litigation and legal fees.

During the course of their interview, Martha and Dwight Jr. expressed concerns about the dispute between Boylan, LLC ("Boylan") and Dardanelle relating to the sale of fourteen acres located in Overland Park, Kansas. On or about September 10, 1997, Boylan entered into a listing agreement with Dardanelle to market and sell the fourteen acres owned by Dardanelle. Boylan, with the assistance of Sterling Financial & Realty, Inc. ("Sterling"), negotiated the sale of the fourteen acres with Cypress Realty, Inc. ("Cypress"). Ultimately, Dardanelle refused to consummate the sale of the fourteen acres to Cypress and sold the property to "DFC."

Boylan and Sterling filed a claim in the District Court of Johnson County, Kansas on or about November 24, 1998 captioned *Sterling Financial & Realty, Inc., et al. v. Dardanelle Timber Co., Inc.*, Case No. 98C14898 (the "Sterling Action"). Boylan and Sterling sought, among other things, \$114,246.99 for the real estate commission on the sale of the fourteen acres. Dardanelle countered that Boylan never had an exclusive sale

agreement and that the agreement expressly stated that the agreed brokerage fee would be paid by Dardanelle if, and only if, the fourteen acres was sold to Cypress. Dardanelle moved for summary judgment and its motion was granted by the District Court on September 30, 1999. The District Court held that the brokerage agreement between Boylan and Dardanelle was non-exclusive. The District Court further held that Boylan and Sterling did not produce a buyer who was “able, ready and willing” to buy Dardanelle’s property and that Cypress and Dardanelle never reached an agreement for the sale of the fourteen acres.

On or about September 20, 2001, Dardanelle filed a malicious prosecution suit against Boylan in the District Court of Johnson County, Kansas captioned *Dardanelle Timber Co., Inc. v. Boylan L.L.C.* Dardanelle asserted that Boylan acted with malice by including material misrepresentations of fact in the complaint filed in the Sterling Action, by not informing the Court of these misrepresentations, and by knowingly participating in efforts to create evidence relied upon to prosecute the Sterling Action which was known to be false and misleading. Dardanelle sought damages consisting of attorneys’ fees, costs and expenses incurred in defending the Sterling Action. On February 6, 2001, Dardanelle offered to settle the malicious prosecution case for \$49,900. After Boylan failed to respond to Dardanelle’s settlement offer, Dardanelle offered to settle the case for \$44,000. Boylan never accepted Dardanelle’s second settlement offer. A two-day jury trial was held on December 4-5, 2001. The jury awarded Dardanelle \$22,054.12.

On April 23, 2003, the United States Bankruptcy Court for the District of Kansas granted an order putting Boylan into Chapter 7 bankruptcy. Lathrop & Gage, L.C. (“Lathrop”), the law firm that represented Dardanelle in its malicious prosecution claim, was appointed as special counsel for the debtor’s estate by order of the Bankruptcy Court dated July 28, 2004. Also on July 28, 2004, the Bankruptcy Court approved a \$20,000 settlement of the claims against Boylan. On August 24, 2004, Boylan paid \$20,000 to the Chapter 7 trustee. On November 9, 2004, Lathrop received \$10,198.04 for reimbursement of expenses and legal fees incurred for its role as special counsel to the debtor’s estate. Lathrop forwarded the \$10,198.04 to Dardanelle on or about November 11, 2004. After the Chapter 7 trustee was compensated \$3,251.13 for his role in Boylan’s bankruptcy, Dardanelle also received the remaining \$6,562.10 of the \$20,000. In short, the Special Committee’s investigation revealed no wrongdoing by the Individual Defendants in connection with the Boylan litigation.

Dwight Jr. also suggested that personal legal matters, including a boundary dispute, were paid for by the Companies. The Special Committee reviewed documents pertaining to the Sutherland-Klein properties and 383rd Street. Dwight Sr., on checks drawn on the account of Latigo Cattle Co. and dated December 9, 1999, October 25, 2000, November 21, 2000, and December 28, 2001, paid Lee Tetwiler for legal work done in conjunction with that matter. The Special Committee also reviewed invoices from the law firm of Shughart Thomson & Kilroy relating to efforts to secure the rezoning of certain real property. For the period July 2001 through November 2006,

approximately \$21,000 has been paid to the Shughart Thomson & Kilroy firm, all by checks drawn on the account of Indian Creek Land & Investment Co. There was no evidence of payment made by the Companies for this work.

2. Concerns Regarding the Companies' Financials.

During the interview by the Special Committee, Dwight Jr. and Martha raised concerns about the size of the "Miscellaneous Expense" category on the Companies' financial statements. Based on its investigation, the Special Committee concludes that Dardanelle had miscellaneous expenses of \$34,903 in 2006, \$48,825 in 2005, \$41,124 in 2004, \$19,647 in 2003, \$55,380 in 2002, and \$36,264 in 2001. Southwest's miscellaneous expenses for the same years were: \$31,154; \$29,570; \$35,776; \$17,277; \$41,622 and \$62,942. These miscellaneous expenses include postage, telephone, office supplies, utilities, insurance, rent and miscellaneous taxes and, for years 2001 and 2002, also included payroll taxes and health insurance premiums which were itemized separately beginning in 2003. There is no evidence to indicate, as plaintiff and Dwight Jr. suggested, that the miscellaneous expense category is being used to conceal improper personal benefits to any of the Individual Defendants.

With respect to the expressed concern regarding travel and entertainment, the Special Committee reviewed the general ledger accounts, which include items for the Companies as a whole, not just Todd and Perry. Moreover, certain of the travel and entertainment expenses are direct billed to the Companies and therefore do not appear on corporate credit card records.

3. Borrowing by the Companies from Family Members and Related Entities.

Dardanelle and Southwest, have, over the years, engaged in the practice of borrowing funds from family members. In that connection, the Special Committee has reviewed schedules of notes payable by Dardanelle and Southwest at year-end from 2001 through 2006, as well as various quarterly reports during those periods, and has checked the prime rates applicable during those periods. With the exception of the longer term notes discussed hereafter and immaterial, isolated exceptions after July 2001, where it appears that a very limited number of ¼% changes in the prime rate were not immediately incorporated by Cimarron into the family short-term lending program, all notes from the Companies to family members and family-owned entities are ninety-day notes with an interest rate at ½% below prime.⁶² Since [REDACTED] is the rate at which the Companies are able to borrow under their [REDACTED] line of credit with Security Bank of Kansas City, the Special Committee concludes that these loans have not disadvantaged the Companies, and in fact advantage them since the Companies are thereby able to avoid reaching the cap on their bank line of credit. As such, these loans

⁶² Prior to February 1, 2000, the Companies' short term borrowing rate was at prime. Consistent with that fact, short term borrowings from family members before that date were also at prime. When the Companies' borrowing rate changed to [REDACTED], and as a result of an administrative oversight at Cimarron, that change was not reflected by Cimarron in the short term borrowing rates it caused the Companies (as well as other Sutherland family companies) to pay family members until July, 2001. None of the affected loans during this period were to Perry, Todd or Mark, and none of the Individual Defendants had any role in the fact that Cimarron did not immediately adjust the rates down by [REDACTED].

do not give rise to actionable self-dealing. *See Sinclair Oil Corp. v. Levien*, 280 A.2d 717 (Del. 1971) (self-dealing requires both advantage to the fiduciary and disadvantage to the corporation).

On November 25, 1998, Dardanelle loaned \$163,400 to Golden Valley Land Development Company (“Golden Valley”). This loan is evidenced by a thirty-year note with principal and interest payable quarterly and bearing interest at a rate of 6.5%. At December 31, 2006, the outstanding balance on the note was \$144,767. Golden Valley is owned 25% by each of Perry, Todd, Martha and Dwight Jr. Since any detriment to the Companies would correspondingly benefit its common stockholders (including Martha and Dwight Jr.) *pro rata*, and in all events involves minimal amounts, if any, the Special Committee has not pursued this matter further.

On July 30, 2004, Southwest borrowed \$780,000 from the Dwight S. Sutherland Revocable Trust on a ten-year note with monthly payments of principal and interest, the final payment being due August 1, 2014 at a fixed interest rate of 6%. The 6% rate, as was the case with respect to the other long-term notes discussed hereafter, was determined by Steve Scott at Cimarron based upon inquiry and/or knowledge as to typical rates at the time of issuance for comparable debt in the commercial markets. This loan funded the acquisition of the El Campo store and is secured by a deed of trust on the property. On January 25, 2005, this note was assigned to the Norma H. Sutherland QTIP Marital Trust (the “Norma Trust”).

On April 24, 2006, Southwest borrowed \$1,000,000 from Latigo Cattle Co., LLC. Latigo is wholly-owned by the Norma Trust, the sole beneficiary of which is the mother of Dwight Jr., Martha, Todd and Perry. This loan is evidenced by a ten-year note due May 1, 2006 with monthly payments of principal and interest at 7% per annum. On April 24, 2006, Southwest also borrowed \$800,000 from the Norma Trust on the same terms, with interest determined in the same manner. These loans funded the acquisition of the Marble Falls store and are secured by a deed of trust on that property.

All of these longer term loans are properly documented and tracked by Cimarron and the interest rates on each were premised upon arm's-length rates at the time of issuance, and all are presently at interest rates below the [REDACTED] the Companies would currently have to pay under their line of credit. For all these reasons, the Special Committee believes that these loans, like the short-term loans, are fair to the Companies.

4. Loans to Todd and Perry.

Dardanelle, with the approval of Dwight Sr., loaned funds to Sutherland Lumber of Arizona, which was a joint venture of Todd and Perry. When the store liquidated in 1997, Perry and Todd personally assumed the unpaid balance of the loan, with initial adjustable rate interest payable at the Nations Bank prime rate. Perry executed a one-year note in favor of Dardanelle dated December 31, 1997 in the principal amount of \$148,328.95. Todd executed a one-year note on the same date in the amount of \$384,711.05. In each case, the interest rate on the loans, adjustable quarterly, was at the Nations Bank prime rate, which at all times was equal to or higher than the

Companies' borrowing rate. Until paid in full, similar notes reflecting the outstanding balance were executed each year.

In each case, the loan principal and interest were paid in full, with the notes executed by Perry being satisfied on February 19, 2002 and the notes executed by Todd being satisfied on July 11, 2003. Given that the interest received by Dardanelle with respect to these notes was at its borrowing rate, the loans were in fact repaid, and there was availability of bank credit exceeding ██████████ throughout this period, the Special Committee concludes that Perry and Todd would be able to demonstrate that these loans were fair to Dardanelle and that the Companies were not damaged as a result of them.

5. The Charitable Contribution.

In paragraph 66 of the Complaint, Martha alleges that Perry and Todd caused Dardanelle, despite net operating losses totaling approximately \$1 million, to make a \$360,000 charitable contribution for the fiscal year ended July 31, 2003, which she speculates were made to "Perry and Todd's favorite charity." In fact, this arose as an integral part of a business transaction to acquire Dardanelle's Brenham, Texas store and not as the result of any decision made by either Perry or Todd.

Dardanelle reported the \$360,000 charitable contribution because of its membership interest in Meridian Group of Kansas, L.C., a Kansas limited liability company formed in March 1999 for the purpose of owning, leasing, and managing real estate ("Meridian"), which made two charitable contributions in December 2002. The

circumstances surrounding Dardanelle's acquisition of its membership interest in Meridian and Meridian's charitable contributions are explained below.

On July 31, 1998, a complex transaction took place involving Wal-Mart Stores East, Inc. ("Wal-Mart"), Dardanelle, DFC Company of Lawrence, L.C. ("DFC"), and Meridian, with Chicago Deferred Exchange Corp. ("Exchange Corp.") acting as an intermediary. Wal-Mart transferred 6.778 acres of land, including a 55,720 square foot retail building, located at 2202 Market Street in Brenham, Texas (the "Brenham Property") to Exchange Corp. in return for [REDACTED]. Dardanelle received the Brenham Property and approximately [REDACTED] from Exchange Corp. and transferred approximately 10 acres of unimproved land located in Overland Park, Kansas (the "Overland Property") to Exchange Corp. Exchange Corp. transferred the Overland Property to DFC, which transferred the Overland Property to Meridian in exchange for a 13.636% non-managing member's interest in Meridian.

On April 29, 1999, Dardanelle transferred 6.15 acres of unimproved land located at 121st Street and Nall Avenue in Overland Park, Kansas, with a market value of [REDACTED], to Meridian in exchange for a 22.727% non-managing member's interest in Meridian. At the time of the exchange, Meridian also owned the Overland Property, which adjoined the 6.15 acres.

On December 18, 2002, Meridian made a contribution of the 6.15 acres to a charitable organization qualified under Section 170(c) of the Internal Revenue Code of 1986. Meridian also sold, during calendar year 2002, the Overland Property to the same

charitable organization. Meridian reported these transactions on its 2002 Federal Form 1065, *U.S. Return of Partnership Income*, and delivered to Dardanelle, as a Meridian member, its Schedule K-1 (Form 1065), *Partner's Share of Income, Deductions, Credits, etc.*, for that year. Dardanelle properly reported, on its federal and state income tax returns for its fiscal year ended July 31, 2003, all items shown on the Meridian Schedule K-1, including its \$359,087 share of the charitable contribution of the 6.15 acres and its \$471,770 share of the long-term capital gain from the sale of the Overland Property.

6. The Charter Amendments.

In the background section of her Complaint (at ¶ 10), plaintiff references the September 5, 2004 amendment to Dardanelle's certificate of incorporation eliminating cumulative voting and the September 29, 2004 amendment to both Dardanelle and Southwest's certificates of incorporation adding the protections from director liability authorized by 8 *Del. C.* § 102(b)(7). While no specific relief is sought with respect to any of these amendments, at paragraph 100 of the Complaint plaintiff does characterize the 102(b)(7) amendments as self-dealing and a breach of fiduciary duty. Notwithstanding the likelihood that these allegations are asserted only as background, the Special Committee has investigated and considered them.

Both the amendment removing cumulative voting and the Section 102(b)(7) amendments were approved by the appropriate boards of directors and acted upon by the 100% written consent of Dardanelle pursuant to 8 *Del. C.* § 228 in the case of the Southwest amendment, and the written consent of the holders of 55% of the voting

interests in Dardanelle in the case of the Dardanelle amendments. The Special Committee understands that these approvals are sufficient as a matter of Delaware corporate law to adopt these charter amendments and that, under the Delaware Supreme Court's decision in *Williams v. Geier*, 671 A.2d 1368 (Del. 1996), and in light of such stockholder approvals, there is not a valid claim of self-dealing or breach of fiduciary duty with respect to these actions. Moreover, the Special Committee notes that the absence of cumulative voting is commonplace, as are Section 102(b)(7) provisions, and that the Section 102(b)(7) protections have no impact on plaintiff's claims in her Complaint, all of which are premised upon theories of breach of the duty of loyalty and bad faith, as distinguished from gross negligence or mismanagement. For all these reasons, the Special Committee does not propose that the Companies take any action with respect to these charter amendments.

V. RANGE OF POSSIBLE RESPONSES AND OTHER CONSIDERATIONS.

Under applicable Delaware law, the Special Committee exercised its informed business judgment to choose a response to the Sutherland Litigation that the SLC reasonably believes is in the best interests of the Companies. The Special Committee considered (1) a determination that some or all of the claims in the Sutherland Litigation be prosecuted against some or all of the individuals named as defendants on behalf of Dardanelle and/or Southwest, either by plaintiff or by one or both of the Companies, (2) a determination that some or all of the claims be settled, and (3) a determination that the Companies should seek a dismissal of the Complaint. The Special

Committee considered whether the substantive allegations of the Complaint appeared consistent with the factual record and consistent with Delaware law.

In reaching its determination, the Special Committee considered those factors which it believed would affect a reasonable businessperson's determination of whether prosecuting the Sutherland Litigation is in the best interests of the Companies, including: its assessment of the likelihood of success of the claims in the Complaint; the likely time until recovery on the claims; the risk that the Individual Defendants would be successful in their defense and would therefore be entitled to indemnification of their legal expenses from the Companies; the direct and indirect uninsured costs to the Companies of prosecution by either plaintiff or one or both of the Companies of the claims in the Complaint, including the impact of pending litigation on the Companies' reputation with employees, vendors, customers and in the community generally; and diversion of management time and resources that would be incurred during the prosecution of some or all of the claims.

VI. DETERMINATION.

For the cumulative reasons set forth in this Report, the Special Committee concludes that there is not a reasonable prospect of success against any of the Individual Defendants with respect to the claims alleged in the Complaint, or with respect to the specific suspicions and charges of wrongdoing raised by Martha and Dwight Jr. during the course of their interview with the Special Committee. In that connection, the Special Committee also considered the probable defenses of the Individual Defendants, including

specifically that certain claims would be barred by the statute of limitations and/or that plaintiff had acquiesced in certain of the conduct of these family-run businesses that she now challenges in this lawsuit. It further considered the costs to the Companies if the claims in the Sutherland Litigation were to proceed including, but not limited to, their uninsured exposure to direct costs and legal fees of their counsel and the Companies' uninsured exposure to indemnification claims for attorneys' fees and expenses from the Individual Defendants if they were successful in defending against the claims in the Complaint. Based on all of the foregoing, the Special Committee has concluded, in the exercise of its informed business judgment, that further prosecution of the Sutherland Litigation on behalf of the Companies is not in their best interests. Accordingly, the Special Committee determines that the Complaint be dismissed, and directs its counsel to cause the Companies to take appropriate action to effect such a dismissal.

The Special Committee notes that it has instructed its counsel to take steps to cause this Report to be filed under seal on an interim basis, pursuant to Court of Chancery Rule 5(g)(3), leaving to the parties in the litigation, and ultimately the Court, a final resolution of what portions, if any, of the Report satisfy the requirements of Rule 5(g) and should remain under seal.

From its investigation, the Special Committee has concluded that the Complaint's portrayal of Perry as a part-time chief executive who is living a lavish lifestyle at the Companies' expense is contrary to the objective truth. The Companies' offices are, by any measure, Spartan. Perry frequently travels to the Companies' store

locations, dining at Taco Bell and Whataburger (not at five star restaurants) and staying at the Hampton Inn, Comfort Suites and LaQuinta (not at exclusive resorts). Commercial flights, when paid for by the Companies, are for coach-class tickets and not first-class airfare. The Companies do not own or pay for company automobiles. Country club membership fees or monthly dues are not paid for by the Companies. There are no lavish trips nor did the Special Committee note corporately financed trips that had a personal flavor.

Many of the employees have a long-standing tenure with the Companies. The Special Committee's interviews noted that all employees approach their jobs with a degree of professionalism and integrity that belies any notion of their involvement in systemic, inappropriate behavior. Quite to the contrary, the Special Committee's investigation showed that where an employee noted a possible error or inconsistency in the coding of an invoice, they immediately called into question the coding and made every attempt to resolve the matter to their satisfaction before proceeding further. Each time the Special Committee inquired as to the potential and/or likelihood that personal invoices were being paid for by the Companies, the same genuine response came back, suggesting that the payment of personal expenses simply does not happen.

When the Special Committee requested documentation, a complete set of back-up documents was delivered that allowed the Special Committee to investigate thoroughly the specific matter and make a determination. As the investigation proceeded, the Special Committee developed a high degree of confidence in the administrative and

internal controls of the Companies. All of the parties to this dispute cooperated with the Special Committee's investigation and certain third parties, including Cimarron and Home Center, devoted substantial time and resources in responding to requests and the Special Committee expressly acknowledges and thanks them for their professionalism.

The Special Committee took significant steps in its efforts to go beyond a surface inquiry by investigating plaintiff's and Dwight Jr.'s claims where specific events were alleged. The results of the Special Committee's investigation would have been quite different and its processes greatly expanded if any of their specific allegations were to demonstrate inappropriate conduct or systemic wrongdoing. However, none did. The Special Committee believes that these broad-ranging allegations of wrongdoing directed at siblings are clear evidence of a much deeper problem that exists between family members.

That said, the Special Committee is not unaware of the significance of corporate aircraft ownership. Perry and Todd have undoubtedly enjoyed the convenience of having access to a private aircraft for personal purposes. There is no doubt that, under any measure, the Companies have subsidized their and other Timesharee's use of the corporate Aircraft and that the cost of this subsidy should continually be squarely in the cross-hairs of cost evaluation by the Companies. However, it does appear that through the Timeshare relationship that exists that ownership costs have been defrayed and that where efficiencies exist, the Companies have tried to take advantage of the opportunity.

What became clear to the Special Committee during its investigation is that this dispute has been, and continues to be, personal. The level of emotion evidenced at various times during the interviews of each of the siblings – Dwight Jr., Martha, Todd and Perry – must be reduced. It is not in the Companies’ best interests that this family feud continue; nor is it in the interests of the siblings or their mother. The Special Committee encourages the parties (and their respective counsel) to pause and reflect on the findings in this Report and thereafter, if at all possible, seek to resolve all of their broader disputes. Neither this lawsuit nor the dynamics that precipitated it should continue.