UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

# Marquis Theatre Corp. v. Condado Mini Cinema

11 Fed. R. Serv. 3d 325 (1st Cir. 1988) · No. Nos. 87-1367, 87-1478 · Decided June 21, 1988

## SUMMARY

The First Circuit reviewed a shareholder derivative action involving alleged self-dealing and mismanagement by George Dennis and related corporations. The court upheld sanctions striking Dennis's pleadings under Federal Rule of Civil Procedure 37, affirmed liability and most damages, and affirmed the attorney's-fee award. It reversed damages attributable to a period when Dennis was not shown to have been responsible for the corporation and reversed repayment of a portion of his salary.

## CASE DETAILS

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| COURT | United States Court of Appeals for the First Circuit |
| WRITING FOR THE COURT | Juan R. Torruella; Levin H. Campbell; Caffrey, Senior District Judge |
| JURISDICTION | Federal |
| DECIDED | June 21, 1988 |
| DOCKET | Nos. 87-1367, 87-1478 |
| DISPOSITION | other |
| PROCEDURAL POSTURE | Appeal by George Dennis from a judgment entered after a bench trial in a shareholders' derivative action. The district court struck Dennis's responsive pleadings as a discovery sanction, found liability for self-dealing and corporate mismanagement, awarded damages and attorney's fees, and permitted the plaintiff to prove a prima facie case despite the stricken answer. |
| STANDARD OF REVIEW | Discovery sanctions are reviewed for abuse of discretion. Factual findings, including liability and damages findings, are reviewed for clear error; evidentiary rulings are reviewed for error. |
| PRECEDENTIAL VALUE | published precedential opinion |
| PARTIES | George Dennis v. Marquis Theatre Corp., Condado Mini Cinema |

## TOPICS

discovery dispute · sanctions · shareholder derivative suits · breach of fiduciary duty · attorney fees

## PRACTICE AREAS

civil procedure · appellate procedure · corporate law · commercial litigation · evidence · remedies

## QUESTIONS PRESENTED

1. Whether the district court abused its discretion by striking Dennis's responsive pleadings under Federal Rule of Civil Procedure 37(b)(2)(C) and (D) after his persistent failure to comply with discovery orders.
2. Whether the plaintiff adequately excused the demand requirement for a shareholders' derivative action under Federal Rule of Civil Procedure 23.1.
3. Whether the evidence supported liability for self-dealing and breach of fiduciary duties.
4. Whether the evidence supported the damages awards, including projected lost profits, personal expenses, condominium maintenance fees, and repayment of three-fourths of Dennis's salary.
5. Whether the district court properly admitted transcripts of Dennis's sworn testimony from bankruptcy proceedings as admissions of a party-opponent.
6. Whether the attorney's-fee award was permissible based on Dennis's obdurate and abusive litigation conduct.

## HOLDINGS

1. A party's continuing refusal to comply with discovery orders may support the striking of responsive pleadings, and a prior lesser sanction does not discharge the party's continuing obligation to comply with the discovery orders.
2. When relevant documents are withheld by a party who possesses them, the trier of fact may draw an adverse inference that the documents would have been unfavorable to that party.
3. Demand on the corporation's board is excused as futile when the entire board is interested in the challenged transactions and the alleged misconduct is not directed to a legitimate corporate purpose.
4. In a self-dealing transaction involving a corporate director or controlling shareholder, the defendant bears the burden of proving both the good faith and the intrinsic fairness of the transaction from the corporation's perspective.
5. Attorney's fees may be awarded for obdurate or abusive litigation conduct even when the opposing defense is not entirely meritless.

## KEY QUOTATIONS

> *"The failure or refusal to produce a relevant document, or the destruction of it, is evidence from which alone its contents may be inferred to be unfavorable to the possessor, provided the opponent, when the identity of the document is disputed, first introduces some evidence tending to show that the document actually destroyed or withheld is the one as to whose contents it is desired to draw an inference."* (846 F.2d at 88)

> *"The demand would be clearly futile here, where the entire Board of Directors is interested"* (846 F.2d at 89)

> *"The district court, therefore, correctly concluded that he had breached his fiduciary duties."* (846 F.2d at 90)

> *"While the presence of merit in a claim or defense may well negate any notion of bad faith in its filing, it certainly cannot justify abuse of the judicial process in the methodology of its prosecution."* (846 F.2d at 91)

### FACTUAL BACKGROUND

Marquis Theatre Corp. owned a 22.5% interest in Condado Mini-Cinema, while George Dennis and his family owned the remaining shares. Dennis controlled several other corporations that leased property to Condado, supplied it with movies, and provided other services, allegedly diverting Condado's profits through self-dealing and mismanagement. Dennis repeatedly failed to produce court-ordered documents and answer interrogatories, and the district court found that he obstructed the litigation and concealed himself from process. The district court nevertheless required the plaintiff to establish a prima facie case and awarded damages based on projected profits and other allegedly improper payments.

### PROCEDURAL HISTORY

Marquis Theatre Corp. filed the derivative action in 1980. After extensive discovery disputes and repeated failures by Dennis to comply with discovery orders, the district court struck his answer and affirmative defenses under Federal Rule of Civil Procedure 37(b)(2)(C) and (D). Following a one-day bench trial in 1987, the court entered judgment for the plaintiff, awarding damages and attorney's fees. The First Circuit affirmed liability, most damages, and the attorney-fee award, but reversed specified damages attributable to a period when Dennis was not shown to have been responsible for corporate decisions and reversed the excessive salary-repayment award.

### DISPOSITION

other

### CASES CITED

- Hammond Packing Co. v. Arkansas, 212 U.S. 322 (1909)
- Knightsbridge Marketing v. Promociones y Proyectos, 728 F.2d 572, 575 (1st Cir. 1984)
- Nation-Wide Check Corporation, Inc. v. Forest Hills Distributors, Inc., 692 F.2d 214, 217-18 (1st Cir. 1982)
- National Hockey League v. Metropolitan Hockey Club, 427 U.S. 639, 642 (1976)
- Untermeyer v. Fidelity Daily Income Trust, 580 F.2d 22, 23 (1st Cir. 1978)
- Heit v. Baird, 567 F.2d 1157, 1161 (1st Cir. 1977)
- In re Kauffmann Mutual Fund Actions, 479 F.2d 257 (1st Cir. 1973)
- Pepper v. Litton, 308 U.S. 295, 306 (1939)
- Ross v. Bernhard, 396 U.S. 531, 538 (1970)
- Runyon v. McCrary, 427 U.S. 160, 183-84 (1976)
- Hall v. Cole, 412 U.S. 1, 4-5 (1973)
- Wright v. Jackson, 522 F.2d 955, 958 (4th Cir. 1975)
- Marston v. American Employers Ins. Co., 439 F.2d 1035, 1042 (1st Cir. 1971)

- Lipsig v. National Student Marketing Ass'n, 663 F.2d 178, 182 (D.C. Cir. 1980)
- Carrillo v. Westbulk, 514 F.2d 1214, 1220 (1st Cir. 1975)
- Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281, 1309 (2d Cir. 1973)
- Lakota Girl Scout Council, Inc. v. Havey Fund-Raising Management, Inc., 519 F.2d 634, 642-43 (8th Cir. 1975)
- Viera v. Arizmendi, 74 P.R.R. 36, 39 (1952)