

Not Reported in Cal.Rptr.2d, 2002 WL 31045495 (Cal.App. 4 Dist.), Blue Sky L. Rep. P 74,285  
**Nonpublished/Noncitable (Cal. Rules of Court, Rules 8.1105 and 8.1110, 8.1115)**  
 (Cite as: 2002 WL 31045495 (Cal.App. 4 Dist.))



California Rules of Court, rule 8.1115, restricts citation of unpublished opinions in California courts.

Court of Appeal, Fourth District, Division 3, California.  
 Sheila FREIBERG et al., Plaintiffs and Appellants,  
 v.  
 PACIFIC SCIENTIFIC COMPANY et al., Defendants and Respondents.  
**No. G027641.**  
**(Super.Ct.Nos. 790706, 790922).**

Sept. 13, 2002.

Debenture holders brought state-law securities fraud action against company that issued debentures, asserting that company's statement announcing redemption of debentures was misleading. The Superior Court, Orange County, Nos. 790706, 790922, [William F. McDonald](#), J., granted company's motion for summary judgment. Debenture holders appealed. The Court of Appeal, [Bedsworth](#), J., held that: (1) statement in company's press release was not misleading, and thus company had no duty to disclose its failed merger talks, and (2) debenture holders were not entitled to amend complaint.

Affirmed.

West Headnotes

**[1] Securities Regulation 349B ↪278**

[349B](#) Securities Regulation  
[349BII](#) State Regulation  
[349BII\(A\)](#) In General  
[349Bk278](#) k. Fraudulent or Other Prohibited Practices. [Most Cited Cases](#)  
 Statement by company's chief financial officer in company's press release stating that redemption of company's bonds was in best interest of company and shareholders was not "misleading" as to bondholders, and thus company had no duty to disclose its failed merger talks under state law, since statement did not mention bondholders and did not mention what was

advisable for them. [West's Ann.Cal.Corp. Code §§ 25400\(d\), 25401.](#)

**[2] Pleading 302 ↪245(1)**

[302](#) Pleading  
[302VI](#) Amended and Supplemental Pleadings and Repleader  
[302k242](#) Amendment of Declaration, Complaint, Petition, or Statement  
[302k245](#) Condition of Cause and Time for Amendment  
[302k245\(1\)](#) k. In General. [Most Cited Cases](#)

Debenture holders were not entitled to amend complaint to add claim for breach of implied covenant of good faith and fair dealing against company that issued debentures, where company claimed that it would have been prejudiced by not being able to take discovery on new claim, and debenture holders offered no explanation for waiting over 18 months from filing of action to add that claim. [West's Ann.Cal.C.C.P. §§ 473](#), sub. (a)(1), [576](#).

Appeal from a judgment of the Superior Court of Orange County, [William F. McDonald](#), Judge. Affirmed. [Susman Godfrey, Marc M. Seltzer and David H. Boren](#); [Lowey Dannenberg Bemporad & Selinger, Stephen Lowey and Vincent Briganti](#); [Pomerantz Haudek Block Grossman & Gross, D. Brian Hufford and Robert J. Axelrod](#) for Plaintiffs and Appellants.

Gibson, Dunn & Crutcher, [Wayne W. Smith](#), [Mary A. Dannelley](#) and [Christopher L. Pitet](#) for Defendants and Respondents.

OPINION

[BEDSWORTH](#), J.

\*1 This is a securities fraud action brought by four investors against the issuer of convertible debentures, its president and directors. The suit alleges the company's statement announcing redemption of the debentures was misleading, and it failed to disclose additional material information needed to make the

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statement accurate. The investors elected to have their bonds redeemed rather than converting them to common stock, a choice they regretted when the stock price later rose.

The investors appeal from summary judgment for the company, arguing there are triable issues of fact and they should have been allowed to file an amended complaint. We conclude there was no error, and affirm.

\* \* \*

The investors are Sheila Freiberg, James Shavick, Lina B. Popper, as trustee, and Jeffrey Doppelt (hereafter, collectively, Freiberg). The suit was brought as a class action and so certified, but the judgment dismissed the complaint only as to these four investors individually. The company is Pacific Scientific Company, and the individual defendants are its president and chief executive officer, Lester "Buck" Hill, and all of its directors (collectively, PSC unless otherwise indicated). The undisclosed information was that PSC had preliminary merger discussions—that led nowhere—before making the redemption announcement. We begin with those talks.

In 1996, PSC was a Newport Beach electronics company, publicly held and traded on the New York Stock Exchange.<sup>FN1</sup> In August 1996, Kollmorgen Corporation, a Massachusetts competitor, contacted PSC to see if it was interested in discussing a possible merger. PSC said it was not, and nothing ensued.

<sup>FN1</sup>. The facts are drawn from the pleadings, the parties' respective statements of undisputed facts, and the evidence submitted on the motion for summary judgment. PSC merged with another company in 1998, and no longer exists.

In July 1997, Kollmorgen's president (Argov) called Hill and proposed they meet to discuss combining the companies. Hill agreed, and they met in Newport Beach on August 1. During the two-hour session, Argov proposed a merger and pointed out the advantages it would offer both companies. Hill said he would consider the issues and get back to Argov.

On August 13, 1997, Argov called Hill to ask if he

had considered the proposal. Hill said PSC was in the middle of a strategic planning process and he would get back to Argov in the fall. Argov said he would call back in September. Argov called again on September 15, 1997, and inquired if Hill had a chance to consider their discussions. Hill replied that he needed another month to finish the planning process.

In mid-October, PSC's directors met to consider the results of its strategic planning. Hill discussed Argov's proposal with the board, which concluded it was not in the company's best interests. However, the board minutes do not indicate this discussion. On October 21, 1997, Argov called Hill to ask whether the planning process had been completed and what he thought of the merger plan. Hill responded that going forward with the discussions would not be in PSC's best interests.

Meanwhile, on November 24, 1997, PSC decided to redeem its outstanding 7 3/4 percent convertible subordinated debentures due in 2003. The aim was to save money, the company having obtained a line of credit with an interest rate that was approximately one point lower than the rate on the debentures. PSC issued a press release the same day announcing the redemption. It stated that holders had until December 8, 1997, to exercise their option to convert to common stock at an effective price of \$19 per share, and all unconverted debentures would be redeemed on December 15, 1997. The release contained this statement by PSC's chief financial officer: "After careful analysis, we believe that the redemption of this issue at this time is in the best interests of the Company and our shareholders."

\*2 From November 24 and December 8, 1997, PSC's stock traded between \$15 and \$16 a share. Most bond holders—Freiberg included—declined the conversion option and allowed their debentures to be redeemed.

On December 9, 1997, Argov called Hill with an offer by Kollmorgen to acquire PSC for \$20.50 a share. A letter containing the details of the proposed transaction followed later that day. Hill discussed the offer with PSC's chief financial officer, concluded it was serious, and began contacting investment bankers to advise PSC. On Friday, December 12, 1997, PSC's board authorized the hiring of investment advisors to evaluate the offer. Hill sent Argov a letter the

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same day, stating PSC would get back to Kollmorgen once it had the chance to fully consider the matter.

Kollmorgen decided not to await PSC's decision, and on Monday, December 15, 1997, made a hostile tender offer for PSC at \$20.50 a share. PSC's stock closed at \$22 a share that day, up from \$15 7/16 on the prior trading day, Friday, December 12. PSC's board determined the offer was not in the best interests of the shareholders, recommended it be rejected, and embarked on a search for another merger partner. In early 1998, PSC was acquired by another company for approximately \$10 a share more than the Kollmorgen offer.

The instant action was commenced in February 1998. Freiberg, a former owner of the subordinated debentures, alleged that PSC's November 24, 1997 press release and notice of redemption, were misleading for failure to disclose the prior merger discussions with Kollmorgen. They claimed this made it appear that redemption was the preferable choice and discouraged conversion. Had the investors known of the talks, they would have elected to convert to common stock and realized substantial gains.

Two causes of action for state law securities fraud are set out, but they allege in substance the same thing.<sup>FN2</sup> One claim is that PSC offered to purchase the debentures and, to induce the purchase, issued the press release which, because it omitted material facts, was misleading, in violation of [Corporations Code sections 25400](#) and [25500](#).<sup>FN3</sup> The other claim is that PSC offered to buy the debentures by means of a written communication that omitted to state material facts and was therefore misleading, in violation of [Corporations Code sections 25401](#), [25501](#), and [25504](#).<sup>FN4</sup>

**FN2.** A third cause of action, for breach of fiduciary duty (failing to disclose the merger talks) was dismissed when the trial court sustained, without leave to amend, PSC's demurrer.

**FN3.** [Corporations Code section 25400](#), subdivision (d) provides, in relevant part, that it is unlawful for any "person ... purchasing or offering to purchase the security, to make, for the purpose of inducing the

purchase ... any statement ... which omitted to state any material fact necessary in order to make the statements made, in light of other circumstances under which they were made, not misleading, and which he knew or had reasonable ground to believe was so false and misleading."

[Corporations Code section 25500](#) provides that a person who willfully participates in an act or transaction in violation of [section 25400](#) shall be liable to anyone who sold a security at a price affected by the act or transaction.

**FN4.** [Corporations Code section 25401](#) makes it unlawful for "any person to ... buy or offer to buy a security ... by means of any written or oral communication which ... omits to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." [Corporations Code section 25501](#) provides that where there is a violation of [section 25401](#), the seller of a security may either sue for damages or seek rescission. [Corporations Code section 25504](#) imposes joint and several liability on the principal executive officer and directors (among others) of any corporation liable under [section 25401](#).

In September 1999, Freiberg moved for leave to amend the complaint to add a cause of action for breach of the implied covenant of good faith and fair dealing. PSC opposed the amendment, arguing Freiberg failed to offer any excuse for the delay in seeking to amend, and it would be prejudiced since the discovery cutoff was September 30, 1999. The trial judge denied the motion. We do not know his reasoning, since no minute order or transcript of the hearing appears in the record.

In January 2000, PSC moved for summary judgment. It argued the press release was not misleading, so there was no duty to disclose, and the merger discussions were not material. In opposing the motion, Freiberg made another last-minute attempt to amend the complaint-this time to add a cause of action for insider trading in violation of [Corporations Code](#)

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[section 25402](#).<sup>FN5</sup> No motion to amend was filed. Rather, Freiberg raised the issue in a footnote at the end of her brief. The trial judge granted summary judgment on the grounds that there was nothing misleading in PSC's press release, and preliminary merger talks were immaterial as a matter of law under [Insurance Underwriters Clearance House, Inc. v. Natomas Co.](#) (1986) 184 Cal.App.3d 1520, 1528, 228 Cal.Rptr. 449. He made no mention of the request to amend.

**FN5.** [Corporations Code section 25402](#) makes it lawful for an issuer, and others, "to purchase or sell any security of the issuer in this state" at a time when it knows "material information about the issuer ... which would significantly affect the market price of that security and which is not generally available to the public," unless the insider has reason to believe the other party to the transaction also has the information.

## I

\*3 [\[1\]](#) Freiberg argues PSC's press release was misleading because it implied that redemption was advisable, and disclosure of the merger talks would likely have resulted in an increase in the stock price and enhanced the desirability of the conversion option. We suspect Freiberg is right about the market response had there been disclosure, but that is neither here nor there. No reasonable person could believe the press release encouraged the bondholders to choose redemption, so it was not misleading. There was no duty to make further disclosure.

The statement in question, made by PSC's chief financial officer in the press release, was this: "After careful analysis, we believe that the redemption of this issue at this time is in the best interest of the Company and our shareholders." Freiberg argues that upon reading this statement, debenture holders could only conclude that redemption was in their best interest. We do not see how. The statement does not mention them. To the contrary, it says that redemption is best for the *shareholders* and the *company*. There is no mention of the debenture holders, nor what is advisable for them. If any inference is to be drawn from this omission, it can only be that PSC had no opinion about what was advisable for the debenture holders

or, worse, that it thought redemption was a bad idea but did not want to say so. There is no way to get from the printed words to any encouragement to redeem rather than convert.

The duty to disclose imposed by [Corporations Code sections 25400](#) and [25401](#) and relied upon by appellants only arises when a prior statement is misleading. Federal securities laws impose the same duty, and numerous federal cases have considered when such a duty arises out of merger discussions. [Glazer v. Formica Corporation](#) (2nd Cir.1992) 964 F.2d 149 is on point and instructive, and it confirms our conclusion that there is no duty to disclose here.

The Glazers acquired 9.9 percent of the stock of Formica Corporation, filed a disclosure statement indicating they might seek to acquire a controlling interest in the company, issued a public statement to that effect, and then sent Formica a letter proposing a friendly acquisition at \$20 per share. The company issued two press releases on September 30, 1988. The first announced the Glazers' offer and the company's response: "[Formica's president] ... stated that it is the position of Formica that it is in the best interests of the Company and its stockholders for Formica to continue as an independent public company...." The second press release said this: " '... Formica Corp [...] will consider any legitimate proposal to acquire the company, a company official said. [¶] 'Any legitimate offer will have to be evaluated by our board of directors,' said Charles A. Brooks, the company's chief financial officer. He said Formica believes the best thing for the company and its stockholders is to remain independent." ( [Glazer v. Formica Corporation, supra](#), 964 F.2d at pp. 151-152.)

\*4 Following these announcements and subsequent press attention, Formica's stock price rose. The Glazers sold their shares at a profit in November 1988. However, Formica went on to consider other mergers or acquisitions, and in 1989, accepted a management-led leveraged buy-out offer at a higher price per share than the Glazers received. ( [Glazer v. Formica Corporation, supra](#), 964 F.2d at p. 152.)

The Glazers sued Formica, principally under section 10(b) of the Securities Exchange Act of 1934, [15 U.S.C. section 78j\(b\)](#) and Rule 10b-5, [17 C.F.R. section 240.10b-5](#). Rule 10b-5 provides, in relevant part,

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that it is unlawful for any person “to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading ..., in connection with the purchase or sale of any security.” (*Ibid.*)

The Second Circuit held Formica was entitled to summary judgment. One of the Glazers' arguments was that a reasonable investor would have understood the September press releases as representing that Formica was not available for acquisition. That was false, the Glazers' alleged, because the company had already received two merger inquiries, and it had started talks with a third company that ultimately resulted in the leveraged buy-out. (*Glazer v. Formica Corporation, supra*, 964 F.2d at p. 155.) The court held there was no misrepresentation. It pointed out that the second press release said Formica would consider any legitimate acquisition offer. Thus, there was “no evidence that could lead a rational juror to infer that a reasonable investor would have construed the September releases as representations that the company was not available for acquisition.” (*Ibid.*)

*Glazer* accords with our view of the evidence in the present case. As we have said, no reasonable juror could find the PSC press release suggested to debenture holders that redemption, rather than conversion, was in their best interest. Therefore, the press release was not misleading and no duty of disclosure of the failed merger talks arose under the Corporations Code.

Freiberg argues that whether a statement is literally accurate is not determinative, and there must be a trial to determine if it was misleading. But the cases it cites are readily distinguishable. For example, *Castellano v. Young & Rubicam, Inc.* (2nd. Cir.2001) 257 F.3d 171, 179 involved a close corporation which had an affirmative duty to disclose without regard to whether prior statements were misleading. In *McMahan & Co. v. Warehouse Entertainment, Inc.* (2nd. Cir.1990) 900 F.2d 576, the claim was that a prospectus, summary of the prospectus, and bond indenture were misleading because they stressed positive information, glossing over negative information that was also buried within the lengthy documents. That is a different species from the one sentence statement made by PSC. And *Lucia v. Prospect Street High Income Portfolio, Inc.* (1st Cir.1994) 36

[F.3d 170, 176](#) held that a trial was required because a reasonable person could find misleading a 10-year return comparison that showed a junk bond fund had higher returns than treasury securities, when a comparison for the immediately preceding six years showed the opposite. Here, by contrast, no reasonable person could find PSC's press release was misleading, since it said nothing that suggested redemption was the bondholders' best choice. Accordingly, there was no duty to disclose the merger talks. The trial judge properly granted summary judgment for PSC.

\*5 Since the duty issue is dispositive, we have no occasion to consider materiality. Specifically, we do not address either the proper test to determine when preliminary merger discussions are material, or whether there are triable issues regarding materiality in this case.

However, we observe that the trial judge was mistaken in believing that *Insurance Underwriters Clearance House, Inc. v. Natomas Co., supra*, 184 Cal.App.3d 1520, 228 Cal.Rptr. 449 established a rule that preliminary merger discussions are immaterial under California law, and that it is the controlling law. First, *Natomas'* statement that preliminary merger discussions are immaterial as a matter of law is dicta, since the court held the omissions involved were not misleading. Second, the statement was one of then-prevailing federal law: The court neither said nor suggested that there is a California rule that preliminary merger discussions are immaterial. That said, we repeat that we do not reach the issue of materiality, and we express no opinion on what test California courts should adopt for materiality in securities litigation arising under the Corporations Code.

## II.

[2] Freiberg also argues the trial judge abused his discretion when he denied her motion to add a cause of action for breach of the implied covenant of good faith and fair dealing, and again when he denied her informal request to add an insider trading count. (*Corp.Code, § 25402.*) But we can find no abuse of discretion in these rulings.

It is within the trial judge's discretion to allow an amendment to the pleadings. (*Code Civ. Proc., §§ 473, sub. (a)(1); 576.*) Denial of leave to amend is

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warranted if there is a long, unexplained delay in bringing the motion, or if the opposing party would be prejudiced by having to undertake additional discovery. (See, e.g., [Green v. Rancho Santa Margarita Mortgage Co. \(1994\) 28 Cal.App.4th 686, 692, 33 Cal.Rptr.2d 706.](#)) The trial court acts within its discretion if the decision is within the bounds of reason, and a reviewing court cannot substitute its decision for that of the lower court where two or more inferences can reasonably be deduced from the facts. ( [Shamblin v. Brattain \(1988\) 44 Cal.3d 474, 478-479, 243 Cal.Rptr. 902, 749 P.2d 339.](#))

We do not know the trial judge's reasoning in denying the motion to add a bad faith claim, since neither the minute order, nor a transcript of the hearing on the motion, is included in the record. Freiberg bears the weight of this omission, since an order or judgment of the lower court is presumed correct, and the appellant bears the burden of affirmatively demonstrating error. ( [Jacques Interiors v. Petrak \(1987\) 188 Cal.App.3d 1363, 1369, 234 Cal.Rptr. 44.](#))

That burden has not been carried. This action was filed in February 1998. PSC's demurrer to one cause of action (breach of fiduciary duty) was sustained, without leave to amend, in June 1998. The discovery cut-off date was September 30, 1999, and Freiberg offered no explanation for waiting until September 7, 1999, to seek leave to amend. PSC argued it would be prejudiced by not being able to take discovery on the new cause of action. Freiberg disagreed, pointing out that the amendment added a new legal theory but no new factual allegations. With no reason for the delay offered, and a claim of prejudice, the trial judge could reasonably deny the motion.

\*6 Nor do we find any abuse of discretion in refusing to allow the insider trading amendment. Once again, we do not know the trial judge's reasoning, since he granted summary judgment without discussing the issue. Nevertheless, we must presume his implicit denial was correct unless shown otherwise. Here, too, Freiberg fails to carry the burden of showing error. She never explained why she failed to present the issue by motion, nor why she waited until the last minute to raise the matter. The unexplained delay would have been sufficient grounds to deny a motion to amend, and that places the matter within the trial judge's discretion, which we have no basis to disturb.

The motion for summary judgment was properly granted, since PSC made no misleading statement that would give rise to a duty of disclosure. There was no abuse of discretion in denying either Freiberg's motion to amend or her later footnote request to amend. The judgment appealed from is affirmed, and respondent is entitled to costs on appeal.

WE CONCUR: [RYLAARSDAM](#), Acting P.J., and [FYBEL](#), J.

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