Unreported Cases

INTRODUCTION

UNREPORTED CASES is a continuing feature of THE DELAWARE JOURNAL OF CORPORATE LAW. All unreported cases of a corporate nature that have not been published by a reporter system will be included. The court's opinions are printed in their entirety, exactly as received.

To expedite the attorney's research, all cases are headnoted according to the National Reporter key number classification system.* Indices are provided for case names, statutes construed, rules of court, and key number and classifications for this issue.

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BRANSON v. EXIDE ELECTRONICS CORP.

No. 11,536

Court of Chancery of the State of Delaware, New Castle

August 11, 1993

Plaintiff brought a class action complaint alleging defendant corporation and several of its directors violated sections 11 and 12 of the Securities Act of 1933. The individual defendants moved to dismiss the complaint for lack of personal jurisdiction.

The court of chancery, per Vice-Chancellor Berger, granted the individual defendants' motion because section 3114, which governs service of process to non-resident directors of Delaware corporations, is not applicable when the cause of action arises solely from a violation of the Securities Act of 1933 and the directors' only contact with the state of Delaware is as directors of a Delaware corporation.

1. Courts ⟹ 12(2)

Constitutional Law ⟹ 305(5)

In determining whether it is appropriate to exercise personal jurisdiction, the court must first determine whether the consent statute applies to the non-resident directors under the circumstances alleged and second, determine whether the exercise of jurisdiction would violate the due process clause of the Fourteenth Amendment of the United States Constitution.

2. Courts ⟹ 12(2)

Both the legislative history of section 3114 and the case law interpreting it mandate the conclusion that section 3114 does not purport to provide jurisdiction with respect to alleged violations of sections 11 and 12 of the Securities Act of 1933. DEL. CODE ANN. tit. 10, § 3114 (1991).

3. Courts ⟹ 12(2)

Delaware courts have construed section 3114 narrowly; reaching only actions which are inextricably bound up in Delaware law. DEL. CODE ANN. tit. 10, § 3114 (1991).

4. Courts ⟹ 12(2)

Constitutional Law ⟹ 305(5)

A Delaware court's exercise of personal jurisdiction over non-resident directors is constitutionally permissible only if the relationship among the individual defendants, the forum, and the litigation is such that requiring the directors to defend an action in Delaware would not offend "traditional notions of fair play and substantial justice."

Pamela Tikellis, Esquire, Carolyn D. Mack, Esquire, of Chimicles, Burt, Jacobsen & McNew, Wilmington, Delaware; Daniel W. Krasner, Esquire, and Edward P. Dietrich, Esquire, of Wolf Haldenstein Adler Freeman & Herz, New York, New York; of counsel; and Charles J. Piven, Esquire, of Baltimore, Maryland, of counsel, for plaintiff.

R. Franklin Balotti, Esquire, Anne E. Foster, Esquire, and Frederick L. Cottrell, III, Esquire, of Richards, Layton & Finger, Wilmington, Delaware, for individual defendants Exide Electronics Corporation and Inco Battery Holdings Corporation.

Donald J. Wolfe, Jr., Esquire, and William J. Marsden, Jr., Esquire, of Potter, Anderson & Corroon, Wilmington, Delaware; and David Clarke, Jr., Esquire, of Piper & Marbury, Baltimore, Maryland, of counsel, for defendants Alex. Brown & Sons Inc. and Donaldson, Lufkin & Jenrette Securities Corporation.

BERGER, *Vice-Chancellor*

This is the decision, following remand, on the question of whether this Court has personal jurisdiction over the members of the board of directors of Exide Electronics Corporation ("Exide") named as defendants in this action.[1] Plaintiff's class action complaint alleges

1. The complaint names Randall C. MacCleary as a defendant, but plaintiff acknowledges that he is not a director of Exide and, therefore, is not subject to jurisdiction pursuant to 10 *Del. C.* § 3114. In addition, defendant Lance L. Knox was not named as a director, although service as attempted pursuant to 10 *Del. C.* § 3114. Plaintiff indicated that he will seek leave to amend his complaint to cure that defect.

that defendants violated Sections 11 and 12 of the Securities Act of 1933, 15 U.S.C.A. §§ 77k, 77*l* (1981), by disseminating a materially misleading registration statement and prospectus in connection with a public offering of Exide common stock.

[1] In deciding whether this Court may exercise personal jurisdiction over the individual defendants, a two-step analysis is employed. First, this Court must determine whether the consent statute used by plaintiff applies to nonresident directors under the circumstances alleged. If so, this Court must then decide whether subjecting the directors to jurisdiction in Delaware would violate the due process clause of the Fourteenth Amendment. *Hercules Inc. v. Leu Trust & Banking*, Del. Supr., 611 A.2d 476, 480-81 (1992).

The individual defendants were served pursuant to 10 *Del. C.* § 3114, which provides in relevant part:

> (a) Every nonresident of this State who . . . accepts election or appointment as a director . . . of a corporation organized under the laws of this State or who . . . serves in such capacity . . . shall, by such acceptance or by such service, be deemed thereby to have consented to the appointment of the registered agent of such corporation . . . as his agent upon whom service of process may be made in all civil actions or proceedings brought in this State, by or on behalf of, or against such corporation, in which such director . . . is a necessary or proper party, or in any action or proceeding against such director . . . for violation of his duty in such capacity . . . .

Plaintiff argues that service is valid under § 3114 even though he is not charging the individual defendants with breach of fiduciary duty. He contends that, under federal law, a director has a duty to assure the accuracy of a prospectus and must sign the registration statement. Both of these acts are performed in the individual defendant's capacity as a director and, thus, the alleged failure to carry out these responsibilities provides the basis for exercising jurisdiction under § 3114.
[2-3] In making this argument, plaintiff is asking this Court to construe § 3114 broadly. However, both the legislative history of this statute and the case law interpreting it mandate the conclusion that § 3114 does not purport to provide jurisdiction with respect to the alleged federal securities law violations at issue here. The legislative synopsis that accompanied the consent statute describes its intended scope:

> The purpose and intent of this legislation is to fill a void in enforcement and interpretation of Delaware corporation laws created by the decision of the United States Supreme Court . . . in *Shaffer v. Heitner*. In that case the Court struck down 10 *Del. C.* § 366 which until now has frequently been the only means whereby nonresident corporate directors of Delaware Corporations could be brought before the courts of this State to answer for their conduct in managing the affairs of the corporation.
>
> * * *
>
> Delaware has a substantial interest in defining, regulating and enforcing the fiduciary obligations which directors of Delaware corporations owe to such corporations and the shareholders who elected them. In promoting that interest it is essential that Delaware afford a convenient and available forum for supervising the affairs of Delaware corporations and the conduct of directors of Delaware corporations. This legislation is designed to accomplish that objective.

Legislative Synopsis to Act of July 7, 1977, 61 Del. Laws, c. 119, *reprinted in Armstrong v. Pomerance*, Del. Supr., 423 A.2d 174, 179 n.8 (1980). Consistent with the stated legislative intent, our Courts have construed § 3114 narrowly, to reach only "actions which are inextricably bound up in Delaware law . . . ." *Armstrong*, 423 A.2d at 177 n.5; *see Prudential-Bache v. Franz Mfg. Co.*, Del. Super., 531 A.2d 953, 955 (1987) (Section 3114 has "been construed to permit jurisdiction over nonresident directors of Delaware corporations only when necessary to define, regulate, and enforce the fiduciary duties and obligations of such individuals to their Delaware corporation and its shareholders."); *Steinberg v. Prudential-Bache Sec., Inc.*, Del. Ch., No. 8173, Jacobs, V.C. (Apr. 30, 1986), mem. op. at 8 ("Section 3114 . . . reaches only lawsuits brought against a nonresident director of a Delaware corporation for acts performed in the defendant's capacity as a director, involving alleged violations of fiduciary duties owed by the director under Delaware law . . . .").

[4] Moreover, if plaintiff's suggested expansion of § 3114 were adopted, the consent statute would be unconstitutional as applied to the facts alleged in plaintiff's complaint. This Court's exercise of personal jurisdiction is constitutionally permissible only if the relationship among the individual defendants, the forum and the litigation is such that requiring these directors to defend an action in this State would not offend "traditional notions of fair play and substantial

justice." *Armstrong v. Pomerance*, 423 A.2d at 176; *see International Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945). Based upon the allegations in the complaint, the only contact the individual defendants have with Delaware is that they are directors of a Delaware corporation. In *In re USACafes, L.P. Litig.*, Del. Ch., 600 A.2d 43 (1991), this Court held that defendant directors are not subject to jurisdiction in Delaware for alleged violations of §§ 11 and 12(2) of the Securities Act of 1933 where defendants' only contact with Delaware is their status as directors:

> Because the Securities Act claims do not arise under Delaware law or otherwise substantially implicate action in or affecting this state, the relationship among those claims, Delaware, and the defendants is not strong enough to permit the exercise of jurisdiction here based solely on the directors' status as directors.

Id. at 54.

Based on the foregoing, the individual defendants' motion to dismiss for lack of personal jurisdiction is granted.

IT IS SO ORDERED.

COHAN v. LOUCKS

No. 12,323

Court of Chancery of the State of Delaware, New Castle

June 11, 1993

Plaintiffs filed a derivative action following an investigation and internal audit of corporate actions to remove itself from the Arab League's boycott list. The company, two subsidiaries and a senior officer, entered into agreements with the federal government regarding alleged civil and criminal violations. Consent agreements were also entered into with the U.S. Department of Commerce. Upon completion of an internal investigation, the board decided not to pursue any claims against individual officers or directors. The proposed settlement was opposed because plaintiffs asserted that the

company's guilty plea to federal charges would assure their success in the underlying derivative action.

The court of chancery, per Vice-Chancellor Berger, concluded that the proposed settlement was fair and reasonable. The court held that even if plaintiffs were to prevail on the demand issue, the evidence suggested that the business judgment rule ultimately would protect the board's decision not to pursue claims against present or former officers.

1. Compromise and Settlement ⟹ 56

Settlements are favored by the courts.

2. Compromise and Settlement ⟹ 2, 56

In reviewing a settlement, the court's function is to consider and weigh the nature of the claim, the possible defenses, the situation of the parties, and exercise business judgment in determining whether the settlement is reasonable.

3. Corporations ⟹ 206(4), 211(5)

The law governing demand futility requires a showing that (1) a majority of the board of directors is not disinterested or independent, or (2) there is a reasonable doubt that the directors are entitled to the protections of the business judgment rule in connection with their involvement in the challenged transaction.

4. Attorney and Client ⟹ 140

Costs ⟹ 165, 172

The amount of attorneys' fees to be awarded is a matter of discretion.

5. Attorney and Client ⟹ 140

Costs ⟹ 172

In determining a reasonable award, the results achieved through the litigation are generally the primary consideration. Other factors

include the time and effort expended by counsel, the complexity of the litigation, the standing and ability of counsel and the contingent nature of the fee arrangement.

Irving Morris, Esquire, and Karen Morris, Esquire, of Morris & Morris, Wilmington, Delaware, for plaintiffs.

Rodman Ward, Jr., Esquire, and Robert A. Glen, Esquire, of Skadden, Arps, Slate, Meagher & Flom, Wilmington, Delaware, for individual defendants.

R. Franklin Balotti, Esquire, of Richards, Layton & Finger, Wilmington, Delaware, for defendant Baxter International Inc.

BERGER, *Vice-Chancellor*

Attached you will find a copy of the Order entered this date approving the settlement presented to the Court on May 7, 1993. The parties are aware that there were numerous written objections and that several objectors appeared at the hearing. I have now fully considered those objections and am satisfied that the settlement is in the best interests of Baxter International Inc. ("Baxter") and its stockholders.

This derivative action is in the last of several arising out of Baxter's efforts to remove itself from the Arab League's boycott blacklist of companies doing business with Israel. Baxter is the world's largest hospital supply company; in 1991 it had sales of more than $8 billion. In 1971, Baxter built a plant for the manufacturer of intravenous solutions in Ashdod, Israel. A few years later, Baxter learned that it was on the Arab League blacklist. Plaintiffs allege that Baxter immediately tried to get itself removed from the list:

> To achieve this, the Individual Defendants caused Baxter to sever business dealings with Israel and join the boycott of Israel by, among other things, selling its profitable Israeli medical supply business, illegally providing information about its Israeli operations to Syria, agreeing to a financially unfavorable deal with the government and military forces of Syria, paying a $2.2 million bribe to a Saudi Arabian concern, and promising Baxter's Arab benefactors that Baxter would not provide Israel with modern or other technology or do any business with it.

Amended Complaint, ¶ 3.

Baxter did attempt to sell its Ashdod manufacturing plant beginning in 1980 and the sale was accomplished in 1988. During the same year that Ashdod plant was sold, Baxter entered into a preliminary understanding with the Syrian government for a project to construct an intravenous solutions manufacturing facility in that country. In 1989 Baxter was removed from the blacklist and in 1990 the company entered into a definitive agreement with Syria to build the manufacturing plant. Defendants maintain that there was no relationship between Baxter's sale of its Israeli plant and its removal from the blacklist. They also deny having bribed anyone and deny any plan to sever business dealings with Israel.

In 1990, Baxter's Audit Committee retained counsel to investigate the circumstances surrounding Baxter's removal from the blacklist. Counsel reported on his investigation in November 1990 and, after considering counsel's report and the Audit Committee's recommendation, Baxter's board of directors determined that no legal action was warranted. This action was filed in October 1991 and the Stipulation of Settlement was executed in March 1993. Pursuant to the proposed settlement, Baxter has agreed to: (i) invest at least $10 million in research and development projects in the State of Israel over a period of five years, and (ii) invest at least seventy-five percent of all net profits from that research and development in additional projects in the State of Israel over the next fifteen years.

A few days after the Stipulation of Settlement was executed, Baxter, two of its subsidiaries, and one of its senior officers entered into agreement with the federal government concerning alleged criminal and civil violations arising from Baxter's removal from the blacklist. Specifically, Baxter pled guilty to an information charging one violation of 50 U.S.C. § 2407(a)(i)(D). In connection with that violation, Baxter agreed to pay a $500,000 fine. The company, two of its subsidiaries, and one of its officers also entered into consent agreements with the U.S. Department of Commerce pursuant to which they agreed to pay civil penalties in excess of $6 million and the companies agreed to a two year ban on new exports to Syria and Saudi Arabia.

[1-2] Settlements are favored by the courts. *Kahn v. Sullivan*, Del. Supr., 594 A.2d 48 (1990). In reviewing a settlement, the Court's function is to "consider and weigh the nature of the claim, the possible defenses, the situation of the parties, and exercise business judgment in determining whether the settlement is reasonable."

Gladstone v. Bennett, Del. Supr., 153 A.2d 577, 583 (1959). In this case, plaintiffs' claims are weak and the settlement, if implemented, would help restore Baxter's public image. On balance, I conclude that the proposed settlement is fair and reasonable.

[3] Some objectors seem to believe that, in light of Baxter's guilty plea, successful prosecution of this derivative claim is virtually assured. In fact, there continues to be a substantial question as to whether plaintiffs would be allowed to pursue their derivative claims. The law governing demand futility requires a showing that (i) a majority of the board of directors is not disinterested or independent, or (ii) there is a reasonable doubt that the directors are entitled to the protections of the business judgment rule in connection with their involvement in the challenged transaction. *Levine v. Smith*, Del. Supr., 591 A.2d 194 (1991).[2]

It appears from this record that a large majority of Baxter's board of directors is disinterested and independent. The Amended Complaint names twenty-three individual defendants, fourteen of whom are current directors of Baxter. Only four of the fourteen are present or former officers of Baxter. There is also a question as to whether plaintiffs could prevail under the second prong of the demand futility test. The record indicates that no current Baxter director was involved in any wrongdoing. Thus, it is not at all clear that Baxter's directors would have to give up their control over this derivative litigation.

Even if plaintiffs were to prevail on the demand issue, the evidence suggests that the business judgment rule ultimately would protect the board's decision not to pursue claims against present or former officers. In 1990 the Audit Committee retained an attorney to investigate all of the same matters addressed by plaintiffs in their Amended Complaint. Based upon that investigation, the Audit Committee recommended to the board of directors that no action be taken. Following the settlement of the government investigations, the Audit Committee and board again considered whether any action should be taken against the corporate officers who entered into the consent agreement. The board decided, on both occasions, that it

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1. The Amended Complaint alleges that the demand issue has been conclusively decided in plaintiffs' favor in the federal court decision in *Miller v. Loucks*, No. 91 C 6539 (N.D. Ill. Nov. 3, 1992). However, the Court there dismissed plaintiffs' breach of fiduciary duty claims for lack of pendent jurisdiction. Accordingly, the federal court's rulings on the merits do not have preclusive effect. *Disher v. Information Resources, Inc.*, 873 F.2d 136, 140 (7th Cir. 1989).

would not be in the best interests of Baxter to pursue the matter further. That decision may well be protected by the business judgment rule. *See Mount Moriah Cemetery v. Moritz*, Del. Ch., No. 11,431, Berger, V.C. (Apr. 4, 1991), *aff'd mem.*, 599 A.2d 413 (1991).

Plaintiffs, who are represented by experienced counsel, thus face a real risk that further litigation would provide no relief. The settlement they negotiated achieves some of what plaintiffs were seeking. It assures that Baxter will be doing business in Israel over the coming years. Several objectors complained that the settlement benefits Israel instead of Baxter, but I think their concerns are misplaced. Baxter suffered significant adverse publicity following the sale of its Ashdod plant, removal from the blacklist and agreement to build a similar facility in Syria. The guilty plea and consent agreements further tarnished Baxter's public image. By committing to ongoing, though relatively small, investment in Israel, Baxter will help restore its reputation and strengthen its relations with customers who had expressed deep concerns over Baxter's past conduct. Moreover, Baxter expects the investment in research and development to be profitable. Thus, it would appear to be a good business decision without reference to the goodwill the investment is likely to generate.

In evaluating the proposed settlement, I reviewed the numerous objections and decided that none warranted rejection of the settlement. I will review some of the more serious concerns briefly. First, there was an objection as to the adequacy of the Notice of Settlement. Some stockholders felt that the guilty plea and consent agreements, entered into after the Notice of Settlement was mailed, should have been the subject of a supplemental notice. Those stockholders also felt that they should have been given more time to evaluate the settlement in light of the plea and related agreements. I find these objections unpersuasive. Baxter's guilty plea and the fines imposed pursuant to the consent agreements were extensively and prominently publicized in newspapers and other media around the country. No supplemental mailing to Baxter's stockholders was required. *See Geller v. Tabas*, Del. Supr., 462 A.2d 1078 (1983). As to timing, Baxter's guilty plea was publicized in late March and the settlement hearing was held on May 7th. I find this to be more than sufficient time for stockholders to evaluate (or reevaluate) their views of the proposed settlement.

One objector expressed concern as to the tax implications of Baxter's guilty plea and the fines it agreed to pay. It appears, however, that the objector's tax analysis was based upon faulty assumptions. There is nothing in this record to indicate that Baxter

will, in fact, suffer any loss of tax credits or exemptions as a result of the guilty plea.

Several objectors also expressed concern that the proposed settlement does not hold any of Baxter's officers or directors accountable for conduct that has injured the company. There are two problems with this objection. First, it assumes wrongdoing on the part of Baxter's officers and/or directors. No such finding has been made by this Court or any other. Second, it assumes that Baxter's stockholders are the ones to decide whether action should be taken against any alleged wrongdoers. As discussed above, under the facts of this case it appears that Baxter's current board of directors would be authorized to make that decision. In fact, the board did conduct a thorough investigation and decided not to pursue any claims against individual officers or directors.

[4-5] Finally, several stockholders objected to the requested fee award of $1 million. The standards governing an award of attorneys' fees in litigation of this sort are well settled:

> In Delaware, the amount of attorneys' fees to be awarded is a matter of discretion. In determining a reasonable award, the results achieved through the litigation are generally the primary consideration. Other factors include the time and effort expended by counsel, the complexity of the litigation, the standing and ability of counsel and the contingent nature of the fee arrangement.

Smith v. Van Gorkom, Del. Ch., No. 6342, Berger, V.C. (October 11, 1985) (slip op. at 2-3). As noted above, I find that the settlement does provide a benefit to Baxter. However, that benefit is not quantifiable. Under a *quantum meruit* approach, and considering the other relevant factors, I conclude that an award of $700,000 is reasonable. The issues in this case are not so complex or unusual as to warrant an extraordinary fee award. In addition, although counsel were operating under a contingent fee arrangement, it appears that much of their time was expended at a point when there was little or no risk that they would go uncompensated. Overall, I disagree with those objectors who suggest counsel for plaintiffs achieved nothing for the company. On the other hand, I conclude that the requested fee award was not supported on this record.

COMMONWEALTH ASSOCIATES v. PROVIDENCE HEALTH CARE, INC.

No. 13,135

Court of Chancery of the State of Delaware, New Castle

October 22, 1993

Plaintiff filed a motion for preliminary injunction restraining defendant corporation from counting the votes of shares of its stock recently issued to another corporation. Plaintiff alleged this transaction represented a radical redesign of a transaction and was intended to interfere with the ability of shareholders effectively to exercise their statutory consent power.

The court of chancery, per Chancellor Allen, concluded that plaintiff had demonstrated a strong probability of success on the merits of its claim. The court issued an injunction enjoining the corporation or its agents from treating the issued stock as validly issued stock for purposes of voting or exercising rights to consent.

1. Injunction ⟹ 14, 138.15, 138.21

An injunction may be issued where plaintiff demonstrates a reasonable probability of success on the merits, that irreparable harm will occur in the absence of the requested relief, and that the harm risked by the denial of the injunction outweighs the harm to the defendant if the injunction is granted.

2. Contracts ⟹ 321

The duty of good faith and fair dealing serves to protect the justified expectations of the parties to the contract.

3. Corporations ⟹ 310(1), 310(2)

A decision to deny consent to a transaction is not a violation of the duty of good faith and fair dealing where that decision is made for a legitimate business purpose.

4. Corporations ⟹ 310(1)

The legal power of directors is subject to an overriding duty of loyalty.

5. Corporations ⟹ 310(1)

Action taken for the sole or primary purpose of impeding the effectiveness of the shareholder vote is deeply suspect and could be sustained only upon the showing of some compelling justification.

6. Corporations ⟹ 307, 310(1)

Acts taken in the ordinary course of the company's business, or indeed extraordinary transactions, may have collateral effects upon a forthcoming vote. any such effect, however, does not constitute an equitable wrong; directors' duty of loyalty to shareholders does not require them to stop managing the enterprise in good faith while a proxy contest or consent solicitation goes forward.

7. Courts ⟹ 85.3

In determining whether or not a party is indispensable, courts examine: (1) to what extent a judgment rendered in the person's absence might be prejudicial to him or those already parties; (2) the extent to which, by protective provisions in the judgment, by the shaping of relief of other measures, the prejudice can be lessened or avoided; (3) whether the judgment rendered in the person's absence will be adequate; and (4) whether the plaintiff will have an adequate remedy if the action is dismissed for nonjoinder. DEL. CH. CT. R. 19(b).

8. Parties ⟹ 24

In determining whether a party is indispensable or not, the four factors listed in Rule 19(b) are not exhaustive; other relevant factors may also be considered. No hierarchy of factors exists.

9. Parties ⟹ 35.85

A properly administered class action, without opt-out rights, could be employed to bind all absent, non-resident shareholders and potential plaintiffs to a final judgment in an action that would determine the rights attaching to corporate stock.

Stephen E. Jenkins, Esquire, Richard D. Heins, Esquire, and Christopher S. Sontchi, Esquire, of Ashby & Geddes, Wilmington, Del-

aware; and Robert W. Forman, Esquire, of Greenberger & Forman, New York, New York, of counsel, for plaintiffs.

Lawrence A. Hamermesh, Esquire, and Seth D. Rigrodsky, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware; Freeborn & Peters, Chicago, Illinois, of counsel; and Schiff, Hardin & Waite, Chicago, Illinois, of counsel, for defendants.

ALLEN, *Chancellor*

Pending is a motion for preliminary injunction restraining Providence Health Care, Inc. ("Providence") from counting the votes of shares of its stock recently issued to NuMed Home Health Care, Inc. ("NuMed"), a Nevada corporation headquartered in Ohio operating home health care services in Pennsylvania and Florida. Commonwealth Associates, the plaintiff in this action, is a shareholder of the defendant, Providence. Individual defendants include Lawrence B. Cummings, Providence's chairman and chief executive officer, and the other directors of Providence, Thomas W. Janes, Brian A. Lingard, and Harvey Wershbale.[1]

This litigation arises from a September 10, 1993 transaction in which (1) Providence acquired 40% of the voting stock of NuMed, together with an option, exercisable until June 30, 1995, to acquire an additional 10% of NuMed's common stock; and (2) NuMed acquired 20% of the voting stock of Providence. NuMed immediately granted a consent to Mr. Cummings to retain the incumbent board to vote these shares. Lawrence Cummings, his brothers, and family own about 30% of Providence's stock on a fully diluted basis.

On August 27, 1993, Commonwealth, a registered broker dealer that had been the underwriter in Providence's February 1992 initial public offering of common stock, commenced a shareholder consent solicitation pursuant to Section 228 of the Delaware General Corporation Law. The purpose of the consent solicitation was to replace Mr. Cummings and other members of the Providence board of directors.

Under the Underwriting Agreement through which the public shares of Providence were distributed, Commonwealth allegedly has

1. Mr. Wershbale, an accountant for over 20 years, had worked at a number of accounting firms, most recently his own in Cleveland, and acquired substantial knowledge of the nursing home industry.

a right for a period of two years to preclude Providence from issuing any additional voting stock but was under an obligation not to unreasonably withhold its consent to such an issuance. Following the initiation of the consent solicitation, Providence apparently felt itself no longer bound by this restriction. In all events, Providence did not give Commonwealth notice of or seek its consent to the transaction in which new stock representing 20% of its voting power was issued to an entity which would in turn be owned at least 40% by Providence.

This suit was initiated by Commonwealth on September 20, 1993. It attacks the Providence/NuMed transaction as representing a radical redesign of a transaction intended to interfere with the ability of shareholders effectively to exercise their statutory consent power. In addition, it attacks the issuance of shares by Providence as a flagrant violation of its contractual duty to plaintiff, which cannot be remedied by money. Moreover, Commonwealth contends that Providence has been guilty of making false and misleading statements to the effect that its consent solicitation has been rendered moot by the acquisition of 20% of Providence's voting stock by NuMed.

The suit seeks equitable relief to remedy these alleged wrongs. Specifically plaintiff seeks an order preventing Providence from effectuating its alleged plan to thwart the effect of the successful completion of Commonwealth's consent solicitation by precluding the county of the vote of any of the shares issues to NuMed. It also seeks an order extending the time in which it might collect consents beyond the sixty days provided for in Section 228[2] and other relief.

I turn first to a statement of the facts as they appear at this stage of the proceeding.

I.

Commonwealth is a broker-dealer with its principal place of business in New York. In February 1992 Commonwealth underwrote on a firm commitment basis an initial public offering of 2,875,000 shares of Providence at $5.25 per share pursuant to an Underwriting Agreement of February 13, 1992. Providence had been formed in

2. This relief is beyond the power of the Court to grant as the terms of the statutory language imposing a 60 day period within which consents may be accumulated is quite clear, precise, and binding.

1989 to acquire nursing home facilities primarily in Ohio by Mr. Lawrence Cummings. Among other terms of the Underwriting Agreement, Providence provided a covenant, with some exceptions not pertinent here, that it would:

> For a period of 24 months after the date of the prospectus, *not, without your prior written consent, which shall not be unreasonably withheld, offer, issue, sell,* contract to sell, grant any option for the sale of, or otherwise dispose of, directly or indirectly, *any shares of Common Stock or other securities of the Company* . . . .

Dukes Deposition Ex. A § 5(g) (emphasis added). The Underwriting Agreement is governed by New York law.

Providence is a small company with less than $500,000 in total net income for 1992.[3] Amory Cummings, Lawrence Cummings' brother, holds a significant number of Providence shares and is Providence's secretary. His law firm, Freeborn & Peters in Chicago, serves as counsel to Providence and advised the company in the NuMed transaction.[4] Ogden Cummings, a former real estate broker, is also a large shareholder and is on retainer by Providence to find real estate acquisitions.

Providence did not fulfill market expectations after the public offering and the stock began to decline. Mr. Cummings was also apparently unhappy about being a public company.[5] When the shares declined from the initial offering price, Providence repurchased 256,000 shares in 1992, 216,850 shares in the first quarter of 1993 and additional shares by July of 1993. Mr. Cummings maintained the belief that the market undervalued Providence stock, then selling at more than $4.00 per share.

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3. Cummings received almost $470,000 is compensation in 1992.

4. Freeborn & Peters was paid $450,000 for its services in 1992.

5. Kamal Mustafa, an investment banker operating through Hamilton Capital Partners, stated in his deposition:

> Larry Cummings expressed distaste for being public, indicated that he had a lot of investors who were being very demanding and who were extremely unhappy with the stock's performance, specifically the company's poor performance three months after the offering, and indicated that he didn't see the price would rise.
>
> And his statement, to the best of my knowledge, was along the lines of, "Well, if the stock drops low enough, maybe the best thing I can do is do a leveraged buy-out and take the company private."

Mustafa Dep. at 17.

After the public offering, there were disagreements between Providence and Commonwealth, including over whether additional shares or options might be issued.[6] When its prior consent was solicited twice in 1992, Commonwealth refused to approve issuances of options to Mr. Cummings, but did agree to issue 127,000 options to Providence employees. Prior to its transaction with NuMed in September 1993, Providence had approximately 3,700,000 shares of which 2,875,000 were distributed to the public in 1992. The shares are publicly traded on the NASDAQ system.

Another crucial player in this story, but not a party to this action, is NuMed. Along with his family, Mr. Jugal Taneja, NuMed's chairman and chief executive officer, owned approximately 40% of NuMed's approximately 5.3 million outstanding shares prior to the Providence transaction. Mr. Taneja also owns Bancapital Finance Corporation of which a subsidiary is A.T. Brod & Company, a small brokerage firm.

In March 1993, a member of A.T. Brod called Mr. Cummings and introduced him to Mr. Taneja and NuMed.[7] Mr. Cummings' initial conception of a small, toe-hold, cash investment in NuMed with future options, is well reflected in a March 23, 1993 memorandum he circulated to his directors and certain managers in which he wrote:

> The sellers are asking for a sale price of $8 million which would be approximately 1 x 1994 projected revenues . . . . It is generally felt that it is important to leave the sellers with a substantial amount of stock in order to incent them to continue to grow the business.
>
> I would *prefer a structure by which Providence would minimize the use of its own stock, minimize the use of cash, and avoid any requirement to continue to fund this acquisition* if we decide in the future that we do not believe this industry is a good fit.

Cummings Dep. Ex. 6 (emphasis added). Cummings early on was not disposed to issue stock to pay for a portion of NuMed.

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6. Commonwealth attempted to nominate Kamal Mustafa to Providence's board pursuant to provisions of the Underwriting Agreement, but his nomination was not approved.

7. A.T. Brod was ultimately paid a $75,000 finder's fee for this introduction.

From the outset of discussions, the transaction under discussion was a two-step deal, with a relatively small cash investment and a large second-step acquisition of stock. At first, Mr. Cummings and Providence dragged their heels to chip away at the cash price of a small stake in a small company, while Mr. Taneja and NuMed were eager to get the deal moving and concluded. The size of the transaction's second step option increased to a maximum 40% stake in NuMed as negotiations continued, but the second step was seen always as more remote and contingent upon positive performance by NuMed. If the investment did not pan out, it could be dropped quickly and relatively painlessly.

Letters between the parties and memoranda from Mr. Cummings to his board reveal the terms of the deal at its inception, and Providence's evaluation of it. Already by early June, Cummings received a proposal that would be followed, if accepted, by a stock purchase agreement. That proposal offered Providence 335,000 shares (about 6%) of NuMed for $1.50 per share at the outset and an option to purchase 300,000 additional shares at $1.75 per share within six months, and 300,000 more shares at $2.00 with a year. The ultimate total consideration sought was $1,627,500 for a 20% stake. In addition to registration and preemptive rights, Providence would have the "observer rights" at NuMed board meetings. The proposal did not mention the use of Providence stock as consideration.

The parties' negotiations continued slowly through June and July, with Cummings seeking a lower price and a larger contingent stake, without sacrificing Providence's ability to drop NuMed if that investment failed to grow. Cummings took the position that the price asked, effectively valuing NuMed as a whole at $8.4 million, was far too high, but liked the liquidity of the investment. Cummings wrote in a June 14 memo that the total value implied a cash flow multiple of over eight times: "Mr. Taneja is in effect buying 'wholesale' and selling 'retail' to us." Yet he continued: "An attractive feature to this acquisition is the fact that we will be getting a marketable security. Our initial investment in NuMed would allow NuMed to be listed on the AMEX, giving us further liquidity." Cummings Dep. Ex. 12.

By late June the parties contemplated a transaction initially for 335,000 shares at $1.25 per share, or five times NuMed's cash flow per share, with variation on the price and timing of the option to purchase additional shares.[8] By June 29, Cummings and Taneja

8. Cummings sought a three year option to purchase up to 40% at a price

preliminarily outlined a transaction in which Providence would purchase 335,000 shares of newly issued NuMed common at $1.25 per share, and receive an option to purchase a cumulative total of 40% of NuMed on a fully diluted basis.

In a June 30 memo to his board, Mr. Cummings outlined the basic structure of the transaction as it existed then: first 8.4% at $1.25 per share; then another 8.4% by November 15, 1993, and any quantity at $1.50 per share, if Providence wanted to take such a stake, or it could hold off until the second quarter of 1994 and buy at a fixed multiple of cash flow.[9] Cummings noted that the transaction would place Providence in the desirable position of being able to augment its investment if NuMed were to prosper, while retaining the ability to get out: "We also, of course, will have some liquidity to sell our investment if we choose to." This memo demonstrates that from the outset, the transaction with NuMed was to provide Providence investment to test the waters with an option to acquire a larger stake later if NuMed fulfilled expectations by making successful acquisitions itself and enabling the companies to realize synergies in their service areas.[10] As late as July 6, liquidity continued to be considered an advantage: "[Providence] would not be irrevocably tying up capital in NuMed . . . . Unlike a nursing home acquisition, we can sell our stock. Any loss on 335,000 shares would not be large." Cummings Dep. Ex. 19.

After almost another month of negotiations, the deal got only slightly better, with the per share price on the last segment of the option dropping from $1.50 to $1.25, at the expense of the disgruntlement of NuMed's principals.[11] At that point, and without a deal, Taneja left for India, and did not return until August 26 or 27.

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to be determined as equal to cash flow per share for the preceding two quarters; Taneja countered with up to 20% to be purchased in the first year at $1.50; and 10% in each of the following two years for five times cash flow, with a minimum tranche of $500,000 in any single purchase. Cummings Dep. Ex. 14.

9. The initial $1.25 price was 5.7 times NuMed's estimated cash flow for 1993. The transaction would have enabled Providence to purchase more shares in the second quarter of 1994 at a fixed 5 times cash flow.

10. Providence chiefly operates nursing homes whereas NuMed focuses on home health care of patients who have been recently released from such on-site care, or who will need such care shortly. Referrals between the enterprises were anticipated.

11. In his memo, Cummings wrote that the principals "have clearly grown discouraged by our protracted negotiations. They have asked for a final indication . . . ." Cummings Dep. Ex. 20.

* * *

In stark contrast to the protracted negotiations between March and July, the events in late August and early September leading up to this motion proceeded with telling alacrity, so much so that a daily chronology at this point is most helpful.

1. On Thursday, August 26, Mr. Cummings sent a marked-up version of Mr. Taneja's July 29 letter outlining the transaction—Providence to buy 6% of NuMed shares for $500,000 with an option exercisable over two years to purchase up to 40% of NuMed's stock. That letter stated that it would probably be possible to close the deal in time to reflect in on NuMed's September 30 financial statements.

2. On Friday, August 27, Commonwealth filed a Schedule 13D and Preliminary Consent Statement with the Securities and Exchange Commission.

3. On Monday, August 30, Messrs. Taneja and Cummings met and worked out the final points of their transaction and agreed to proceed with a contract. On that same day, Freeborn & Peters learned of the initiation of the consent solicitation. Tom Fitzgerald, a partner at the firm and counsel to Providence, immediately researched New York and Delaware[12] law regarding a possible breach of the Underwriting Agreement with Commonwealth.

4. On Tuesday, August 31, Lawrence Cummings learned of the consent solicitation at about 9:30 a.m. Mr. Cummings immediately consulted with lawyer Fitzgerald and his brother Amory. Mr. Fitzgerald advised Mr. Cummings that, in his opinion, Common wealth's consent solicitation constituted a breach of the implied covenant of good faith and fair dealing of the Underwriting Agreement, as well as Commonwealth's fiduciary duties as underwriter to Providence. Moreover, Fitzgerald expressed the view that since, in his view, Commonwealth had first breached the contract, Providence was no longer obligated to abide by the stock sale restrictions of the Underwriting Agreement, and could issue shares of Providence in the NuMed transaction.

5. On Wednesday, September 1, Cummings hired MacKenzie Partners as proxy solicitors. On this same day, Mr. Taneja saw a newspaper article reporting Commonwealth's 13D filing and when

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12. During discovery, Commonwealth sought information about the legal advice rendered at this time but defendants claimed that the attorney-client privilege protected that information from disclosure.

he called Mr. Cummings asking if their deal were still "on," Cummings responded affirmatively. Mr. Taneja had faxed a copy of the terms agreement as it had just been worked out. But later that day, Cummings, with Mr. Fitzgerald on the line, called Mr. Taneja and asked him if he would entertain doing the entire deal in a single step. Mr. Taneja responded that he was unable to conclude anything on the phone, but that Mr. Cummings should come to Cleveland and they would consider a deal.

6. The next day Mr. Cummings was in Cleveland. A new deal was negotiated. Taneja described the tenor of the negotiations: "Busy discussions between me and Larry [Cummings]. We were using four conference rooms of [NuMed counsel] and were trying to negotiate the whole deal." Messrs. Cummings and Taneja agreed to terms which became finalized in the Stock purchase and Exchange Agreement ("Stock Purchase Agreement") executed September 10 between NuMed and Providence.

7. On Friday, September 3, Providence hired Mesirow Financial, Inc., a Chicago based firm, to issue a fairness opinion on the terms reached the previous day. The opinion was to be delivered orally at the September 7 board meeting. On this same day, Freeborn & Peters sent a draft of the final agreement to NuMed's counsel, Arter & Hadden in Cleveland.

8. Over the Labor Day weekend, September 4 through 6, Mesirow conducted due diligence and performed its financial analyses on NuMed using NuMed's estimated projected earnings.

9. On Tuesday, September 7, and Wednesday, September 8, the Providence board held a special meeting and discussed both the NuMed transaction and the consent solicitation. Mr. Fitzgerald repeated the advice he had given Mr. Cummings earlier regarding "Commonwealth's breach of the underwriting agreement and [Providence's] new ability to issue and sell stock free of the restriction on such activities." Fitzgerald Aff. at 3. On September 8, Mr. Cummings and his friends and directors Lingard and Janes voted to approve the transaction, although Mr. Wershbale, the accountant, abstained, claiming that he felt he lacked necessary financial calculations to make an informed decision.[13]

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13. Mr. Wershbale stated that during the meeting he had asked:

> if the earnings per share would be negatively or positively impacted, and was advised of certain possibilities that were calculated during the course of the actual board meeting. And I was of the opinion that it should be

10. On Friday, September 10, the Stock Purchase Agreement was signed and the transaction closed the same day. Unlike the two step transaction contemplated throughout the spring and summer, the contract agreement provided for a compressed, one shot acquisition of 40% of NuMed with an option to purchase 10.1% more of NuMed within three years in exchange for 20% of Providence plus cash.

Under the Stock Purchase Agreement, Providence purchased 3,350,500 shares of NuMed common stock (about 40%) and an immediately exercisable warrant to purchase 1,695,328 more shares for $2,966,824 with a June 30, 1995 expiration date, for an ultimate total of 50.1% stake in NuMed on a fully diluted basis. For its investment, Providence would also have the power to name four directors to NuMed's board which was increased by NuMed from seven to eleven directors. In the transaction, NuMed received 925,000 shares of Providence common stock or 20% of its outstanding stock,[14] a cashier's check dated September 7 for $500,000 (allocated $375,000 for the NuMed shares and $125,000 for the warrant), and a seat on Providence's now five-member board of directors.[15]

As interesting as the financial aspects of the deal were voting provisions and ancillary agreements concerning the transaction.[16] Section 4.1(b) provided that:

> *without the prior written consent of the Board of Directors of the other party*, neither party shall, directly or indirectly, alone or in concert with another Person: . . . (iii) make, or in any way participate, directly or indirectly, in any solicitation of proxies, consents, or authorizations (as such terms are used in the proxy rules of the SEC) to vote, or seek to advise or influence any person with regard to the voting

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done more exactly. And once I had that information, I would be in a position to vote on the deal.

Wershbale Aff. at 67.

14. This number of shares was calculated based on a 30 day trading average prior to the closing of $3.50 per share.

15. The cash infusion was a crucial part of the deal for Taneja who himself wanted to make an acquisition in Florida and had pledged personal assets to obtain credit and wanted to release his own funds.

16. It is also interesting to note that as part of the agreement, Providence would make available to NuMed a $1 million line of credit for acquisitions to be approved by Providence, and $500,000 in working capital for a home health care expansion joint venture in Ohio, of which Providence would take a 75% interest.

> of, any equity securities, *in opposition to a position the board of directors has taken.*

Taneja Dep. Ex. 1 (emphasis added). This provision, plaintiffs claim, has the effect of locking up NuMed's votes in any consent solicitation. In a September 10 letter agreement which referenced the indemnification provision of the contract, Providence agreed to indemnify NuMed against any violations of the Commonwealth Underwriting Agreement.[17] In other September 10 letters, Messrs. Cummings and Taneja each agreed as shareholders of their respective companies that they would vote their shares in favor of the other company's representatives for their respective boards of directors.

11. On September 13, MacKenzie Partners issued a press release stating that NuMed and Providence had concluded a transaction.

12. On September 15, Providence announced that it had effectively won the control contest against Commonwealth by noting that shareholders representing over 50% of the company's outstanding common stock had tendered their consents in favor of the current Providence board. Even were Commonwealth's consent solicitation successful, the results would be immediately reversible based on the consents obtainable from Mr. Cummings (30%) and NuMed alone. The announcement included a statement by Mr. Taneja: "The current composition of Providence's board has NuMed's full support." Messrs. Taneja and Cummings each had tendered written consents in favor of the Providence board.

I I.

[1] The standard for the issuance of a preliminary injunction is well settled and familiar. An injunction may issue where plaintiff demonstrates a reasonable probability of success on the merits, that irreparable harm will occur in the absence of the requested relief,

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17. The letter signed by both parties stated:

> PHC hereby agrees to indemnify, defend and hold harmless NuMed from and against any and all costs, expenses, obligations, liabilities, damages, recoveries and deficiencies, including interest, penalties and reasonable attorneys' fees, that NuMed shall actually incur as a result of any claim or assertion of liability brought by Commonwealth Associates against PHC and/or NuMed *relating to the Underwriting Agreement dated as of February 13, 1992, between PHC and Commonwealth Associates*, or the transactions contemplated by this Agreement.

Taneja Dep. Ex. 1 (emphasis added).

and that the harm risked by the denial of the injunction outweighs the harm to the defendant if the injunction is granted. *Allen v. Prime Computer Inc.*, Del. Supr., 540 A.2d 417, 419 (1988).

III.
Breach of Contract Claim

Commonwealth has presented a strong probability of success on its claim that the issuance of common stock to NuMed constituted a breach of the Underwriting Agreement.

The Underwriting Agreement itself appears clear in its requirements that Providence receive the consent of Commonwealth to any stock issuance for a term of two years, and that Commonwealth's consent is not to be unreasonably withheld. It is also undisputed that Providence failed to seek Commonwealth's consent to the stock issuance.

[2-3] Furthermore, Commonwealth's exercise of its statutory right to seek consents from other shareholders is unlikely to be found to be a violation of an implied covenant of good faith and fair dealing under the Underwriting Agreement as defendants contend. The duty of good faith and fair dealing serves to protect the justified expectations of the parties to a contract. *See Restatement of Contracts 2d* § 205. Thus, to find that the solicitation of consents constitutes a breach of this duty, one must find that it was a justified expectation of the parties to this contract that Commonwealth, as a stockholder, would be restricted under the Agreement from exercising a statutorily granted right inherent in stock ownership. Such a conclusion is not supported by the record, nor by any authority cited by Providence.[18] Indeed, there is authority to support the contention that a decision to deny consent to a transaction is not a violation of the duty of good faith and fair dealing where that decision is made for a legitimate business purpose. *Bonady Apts. v. Columbia Banking Fed. Sav. & Loan Assoc.*, N.Y. Supr., 465 N.Y.S.2d 150, 154 (1983), *modified*, 472 N.Y.S.2d 221 (4th Dept. 1984).

Finally, it seems clear that Commonwealth, as a public shareholder, could reasonably have disapproved of the issuance of stock to NuMed, in light of the implications the transaction has in forming

18. It should here be noted that although Providence submitted an affidavit of counsel to the effect that counsel advised Cummings that the consent solicitation violated the duty of good faith and fair dealing, no authority is cited which leads to this conclusion.

a powerful control structure. I do not know if the business terms of the transactions are good, from Providence's point of view, or not. Nor need I know that. I suppose that reasonable minds might disagree about it. But without regard to the business terms it seems perfectly clear that public shareholders could reasonably resist a transaction that they could interpret as placing control of the corporation in Mr. Cummings in a much more entrenched way than heretofore.

Thus, I regard Providence's argument that it was not required to seek Commonwealth's consent to the issuance because a denial by Commonwealth of its consent would have been per se unreasonable to be transparently incorrect.

For these reasons, I conclude that Commonwealth has demonstrated a strong probability of success on the merits as to its claim that the issuance of stock to NuMed was a breach of the Underwriting Agreement.

I V.
Intentional Interference with Voting Rights

The exercise of legal power over the corporation by a board of directors is subject to a duty of loyalty to the corporation and, in certain contexts, to the stockholders directly. This duty is of old, indeed ancient, origins—finding early expression in the development of the use and trust by the English Chancellors, in which equitably enforced duties were first held to constrain the exercise of incontestable legal power—but it is vital to the functioning of corporate law today. The corporation form has utility in large part because owners of capital are willing to commit their capital to an enterprise in exchange for a security with no maturity date or enforceable right to a return. In a technological, market economy these corporate enterprises require broad power and discretion in the hands of boards and managers in order to enable the enterprise to adapt to changing markets in a timely way. These two factors—the need for some assurance of fair treatment and the need for open-ended assignments of power to corporate boards—define the need for a post-hoc judiciary fiduciary remedy; such a remedy will, in fact, make the corporate form more useful.

[4-5] Delaware cases have recognized that the legal power of directors is subject to an overriding duty .of loyalty. *E.g.*, *Schnell v. Chris-Craft Indus.*, Del. Supr., 285 A.2d 437 (1971); *Condec Corp. v. Lunkenheimer Co.*, Del. Ch., 230 A.2d 769 (1967); *Mills Acquisition Co. v. Macmillan, Inc.*, Del. Supr., 559 A.2d 1261 (1989). Our cases

have also noted that the shareholder franchise occupies a place of extreme importance in the theory of corporation law. It is only by reason of their election by shareholders that individuals are granted the right, for a period, to exercise the power of corporate directors. Thus, it has been held that action taken for the sole or primary purpose of impeding the effectiveness of the shareholder vote is deeply suspect and could be sustained only upon the showing of some compelling justification. *Blasius Indus., Inc. v. Atlas Corp.*, Del. Ch., 564 A.2d 651 (1988).

[6] It is, of course, the case that acts taken in the ordinary course of the company's business, or indeed extraordinary transactions, may have collateral effects upon a forthcoming vote. Any such effect, however, does not constitute an equitable wrong; directors' duty of loyalty to shareholders does not require them to stop managing the enterprise in good faith while a proxy contest or consent solicitation goes forward.

In this case, however, a preliminary assessment of the record is radically inconsistent with the interpretation that Mr. Cummings happened to negotiate the sale of 20% of Providence stock into friendly hands (so friendly indeed that Cummings indirectly controls 40% of its vote and has an option on another 10%) just three days after learning of the commencement of the solicitation of consent. Plainly the effect that stock placement had on the consent solicitation was not collateral or secondary but was the main, principal, indeed probably the sole, reason to acquire immediately, and for Providence stock, a larger interest in NuMed that had only days earlier been thought a contingent future proposition.

V.
Threats of Irreparable Injury

Plainly the effect of the transaction is to place Mr. Cummings in a securely entrenched position. Indeed, promptly after the transaction closed, a press release announced in effect that plaintiff's consent solicitation was futile. And, if the last minute changes in this transaction are valid, so it is.

If one concludes that Section 228 creates a right in corporate shareholders to take effective action and that the duty of loyalty ought to bar those in control of the corporation from taking action designed solely or primarily to thwart effective exercise of that right, then I conclude that it follows that the bare-bones facts not in dispute show that it is quite likely that a wrong has been done here. More

to point, that violation of statute and fiduciary duty and breach of contract will cause injury that is difficult or impossible to quantify. In these circumstances, the violation of duty shown supports findings of irreparable injury. *See Prime Computer Inc. v. Allen*, Del. Ch., No. 9557, Allen, C. (Jan. 23, 1988).

V I.
Indispensable Parties

Although an order granting the relief sought will impact the legal rights of an absent party, NuMed, a close examination of the unusual circumstances of this case in conjunction with a reading of Rule 19(b) leads me to conclude that a preliminary injunction against Providence is not precluded by NuMed's absence.

Amended Rule 19(b) sets forth a structure for the relevant factors to be considered in determining whether the absence of NuMed, a Nevada corporation, prevents the issuance of a preliminary injunction against a Delaware corporation and its board in an action. Rule 19(b) was amended in 1966 to reflect the more fact and circumstances oriented "equity and good conscience" test and to reject the old style, mechanistic application of the rule generally adopted by courts prior to 1966. *See* 7 Wright, Miller & Kane, *Federal Practice and Procedure* § 1607 (1986).

Older Delaware cases may be viewed as adhering to that earlier construction of Rule 19 which focused on labelling a party first and thereby determining that it was indispensable, as opposed to examining closely the circumstances of the case before arriving at a conclusion regarding a person's indispensability, as is now required under Rule 19(b). *See, e.g.*, *Chappel v. Standard Scale & Supply Corp.*, Del. Ch., 138 A. 74 (1927); *Bouree v. Trust Francaise des Actions de la Franco-Wyoming Oil Co.*, Del. Ch., 127 A. 56 (1924). In *Hodson v. Hodson Corp.*, the Chancery Court conclusively stated: "It is the rule, long settled in this state, that the owner of shares of stock in a Delaware corporation is an indispensable party to an action to cancel such shares or to restrain the voting of or the payment of dividends on such shares. As the owner of the shares in controversy, Jessie Blanche Price is, therefore, an indispensable party." *Hodson v. Hodson Corp.*, Del. Ch., 80 A.2d 180, 181 (1951) (citations omitted) (finding individual defendant an indispensable party in an action for fraud in the issuance of shares to her and requiring surrender and cancellation of her shares for relief). The *Hodson* court's determination that a person was indispensable without any consideration of the

circumstances of the case illustrates the early formulaic application of Rule 19(b). In considering now whether a shareholder is an indispensable party to an action adjudicating rights arising from stock, one might reach the same result as the earlier cases, but if so it would be by a different route.

[7-8] More recent Rule 19(b) analysis has afforded courts the opportunity to consider a richer factual context in determining whether a party is indispensable or not. Rule 19(b) itself provides four factors:

> first, to what extent a judgment rendered in the person's absence might be prejudicial to him or those already parties; second, the extent to which, by protective provisions in the judgment, by the shaping of relief or other measures, the prejudice can be lessened or avoided; third, whether the judgment rendered in the person's absence will be adequate; fourth, whether the plaintiff will have an adequate remedy if the action is dismissed for nonjoinder.

Ch. Ct. R. 19(b) (1987). Other relevant factors may also be considered, and no hierarchy of factors exists:

> the list in subdivision (b) does not exhaust the possible considerations the court may take into account; it simply identifies those that will be most significant in most cases. Moreover, the rule does not state what weight is to be given each factor. This must be determined by the court in terms of the facts of a given case and in light of the governing equity-and-good-conscience test. Thus, to a substantial degree the effective operation of the rule depends on the careful exercise of discretion by the [trial] court.

7 Wright, Miller & Kane, *supra*, § 1607.

In this case, the standard four factors plus one additional relevant factor do tip in favor of the issuance of a preliminary injunction against the voting or the counting of the votes of Providence shares recently issued to NuMed. I understand that NuMed may be prejudiced by this injunction, and that the order cannot be fashioned in such a way as to prevent such prejudice. Nevertheless, a judgment rendered that does not affect NuMed's stock interest will plainly be inadequate and Commonwealth will not have an adequate remedy if no relief with respect to NuMed's stock can be given for want of NuMed as a party since it will have lost its ability fairly to engage in this consent solicitation.

[9] I must consider an additional factor in this case, that is, the protection afforded NuMed in these proceedings by Providence's diligent defense of the validity of the transaction. Providence's and NuMed's interests, for all purposes relevant here, are essentially congruent. In *Hynson v. Drummond*, this court held that a properly administered class action, without opt-out rights, could be employed to bind all absent, non-resident shareholders and potential plaintiffs to a final judgment in an action that would determine the rights attaching to corporate stock. *Hynson v. Drummond Coal Co.*, Del. Ch., 601 A.2d 570, 575-76 (1991) ("I suggest that it would be radically inconsistent with our history to suppose that binding an absent shareholder to an actual adjudication in the corporate domicile of the corporate rights of holders of stock is in any sense unfair to that absent shareholder (assuming notice and opportunity to heard has been afforded)."). In defending itself in this action, Providence has effectively sought to protect its investment in NuMed, an investment integrally related to the voting power of NuMed's shares in conjunction with Mr. Cummings' own. Since an adequate defense of the transaction has been put on by Providence, prejudice to NuMed must be considered in a different light than it might have been had Providence not acted, *de facto*, as its champion.

In equity and good conscience, the absence of NuMed should not preclude the order sought upon consideration of the following facts.

First, NuMed knew of the February 13, 1992 Underwriting Agreement and bargained for not only an indemnification provision in the Stock Purchase Agreement, but also a letter agreement upon closing that Providence would indemnify NuMed specifically for any expense or liability it might incur as a result of a breach of that agreement.

Furthermore, Mr. Taneja knew about the consent solicitation and understood the connection between his transaction and the control contest. In light of the consent solicitation, he pointedly called Mr. Cummings and asked whether the deal was still "on." It would not be unreasonable to conclude further that Mr. Taneja realized that due to pressure to place a significant number of shares in friendly hands he was in a much better bargaining position on September 1 than he had been just days before. Including voting provisions in the Stock Purchase Agreement and granting consents and voting support for board members in letters at the September 10 closing just days after both parties learned of the consent solicitation, Messrs.

Cummings and Taneja concluded their speedy negotiations with a purpose in mind.

Finally, as a result of notice ordered by this court, NuMed has been apprised of this action and has chosen not to appear. Mr. Taneja, a nonparty, was voluntarily deposed, but he has chosen, perhaps at the suggestion of defense counsel, not to appear.

In light of all of these considerations, I cannot conclude that the absence of NuMed as a party precludes the court from enjoining Providence and the individual defendants from effectuating finally the plan that has been preliminarily proven to thwart the exercise of stockholder consent rights.

* * *

An injunction will issue enjoining the corporation or its agents, until further order of this court, from treating the stock issued to NuMed as validly issued stock for purposes of voting or exercising rights to consent. I will be prepared to try the case on a rapid schedule so that the situation may be quickly and finally resolved. In reaching this conclusion, I have considered the off-setting claims of loss that issuance of the injunction might occasion, but on balance the issuance of the injunction appears the better and fairer course.

Plaintiffs may submit a form of implementing order.

DELPHI EASTER PARTNERS LIMITED PARTNERSHIP v. SPECTACULAR PARTNERS, INC.

No. 12,409

Court of Chancery of the State of Delaware, New Castle

August 6, 1993

Plaintiffs, the two limited partners of Easter Show Limited Partnership, filed suit individually and derivatively on behalf of the partnership against defendants, including the general partner, charging that defendants improperly used partnership funds to pay legal fees and expenses incurred by the defendants in defense of other litigation brought by plaintiffs. The issue was briefed and argued in the context of cross motions for summary judgment.

The court of chancery, per Chancellor Allen, granted partial summary judgment in favor of defendants, finding that under the Delaware Revised Uniform Limited Partnership Act a partnership agreement may indemnify partners or others, and that the partnership agreement did, in fact, indemnify defendants under the circumstances. The court further found that the partnership agreement and public policy warrant finding that defendants are entitled to receive advances on indemnification claims for their reasonable litigation expenses incurred as a result of their involvement with the partnership.

1. Partnership ⟹ 71, 349

The Delaware Revised Uniform Limited Partnership Act provides that, subject to standard and restrictions set forth in the partnership agreement, a limited partnership may indemnify and hold harmless any partner or other person against any and all claims and demands. DEL. CODE ANN. tit. 6, § 17-108 (1990).

2. Partnership ⟹ 71, 349

Section 17-108 is broader than the statutory indemnification provision applicable to corporations, as it defers completely to the contracting parties to create and delimit rights and obligations with respect to indemnification and advancement of expenses. DEL. CODE ANN. tit. 8, § 145 (1990).

3. Partnership ⟹ 71, 349

In construing contractual rights under the Delaware Revised Uniform Limited Partnership Act conferring rights of indemnification, courts should interpret language so as to achieve where possible the beneficial purposes that indemnification can afford, including allocation of certain risks at the outset of the contractual relationship in order to make the contractual structure more feasible or attractive to the participants.

4. Partnership ⟹ 71, 349

Because the parties seeking indemnification meet the contractual conditions set forth in the partnership agreement, they are entitled to be indemnified under the partnership agreement.

5. Partnership ⟹ 71, 349

The public policy of Delaware is to allow advancement, if the partnership agreement so provides, even in cases in which the plaintiff is a limited partner and the claims are for breach of fiduciary duty.

6. Judgment ⟹ 228

Summary judgment may be granted when there exists no genuine issue of material fact with regard to the issues to be decided and the movant is entitled to judgment on those issues as a matter of law.

William Prickett, Esquire, and Ronald A. Brown, Jr., Esquire, of Prickett, Jones, Elliott, Kristol & Schnee, Wilmington, Delaware, for plaintiffs.

William D. Johnston, Esquire, and Jan R. Jurden, Esquire, of Young, Conaway, Stargatt & Taylor, Wilmington, Delaware; and Ronald S. Rauchberg, Esquire, David L. Goldblatt, Esquire, Lawrence P. Eagel, Esquire, and Isaac Montal, Esquire, of Proskauer, Rose, Goetz & Mendelsohn, New York, New York, of counsel, for defendants.

Joseph A. Rosenthal, Esquire, of Rosenthal, Monhait, Gross & Goddess, P.A., Wilmington, Delaware, for defendant Easter Show Limited Partnership.

ALLEN, *Chancellor*

This is an action brought derivatively and individually by the two limited partners of Easter Show Limited Partnership ("ESLP"), a Delaware limited partnership, against the general partner, Spectacular Partners, Inc., its parent, Radio City Music Hall, Inc. ("RCMH"), and others. It charges that defendants have improperly diverted ESLP funds by paying legal fees and expenses incurred in defense of other litigation in this court instituted by these plaintiffs against these defendants (the "Dissolution Litigation"). That other litigation sought dissolution of ESLP and sought the award of money from defendants. The gist of that claim is that RCMH and the other defendants deliberately failed and refused to develop the business of

ESLP and failed correctly or adequately to account for their management of ESLP. Following trial these charges were in all substantial respects found to be unjustified. *See Red Sail Easter Ltd. Partners, L.P. v. Radio City Music Hall Productions, Inc.*, Del. Ch., No. 12,036, Allen, C. (July 28, 1993).

As a subsidiary part of the post-trial briefing of the Dissolution Litigation, the parties presented and briefed cross motions for summary judgment in this case. That matter was reserved in the July 28, 1993 memorandum opinion for later treatment.

For the reasons set forth below, partial summary judgment will be granted to defendants declaring that they are entitled to receive advances on claims of indemnification for their reasonable litigation expenses incurred in connection with their defense of the Dissolution Litigation.

I.

Before examining the issue the parties present, whether defendants were entitled to receive advance indemnification payments for their legal expenses, I first turn to the somewhat different and more basic issue, whether defendants will be entitled to receive indemnification after the termination of the Dissolution Litigation. As explained by the analysis below, under the holdings of the July 28 opinion in the Dissolution Litigation, defendants will be legally entitled to receive indemnification from ESLP for their litigation expenses. This conclusion while provisional, since there is in that case, as yet, no final judgment not subject to appeal, is nevertheless somewhat helpful, in that it supplies context for consideration of the advancement claim.

(a) *Defendants' contractual and statutory rights to indemnification*

[1] Section 17-108 of the Delaware Revised Uniform Limited Partnership Act ("DRULPA") provides: "Subject to such standards and restrictions, if any, as are set forth in its partnership agreement, a limited partnership may, and *shall have the power to, indemnify and hold harmless any partner or other person from and against any and all claims and demands whatsoever.*" *See* 6 *Del. C.* § 17-108 (1990) (emphasis added).

This provision, enacted in 1985, is broadly enabling. It might be compared to the partnership indemnification provision, 6 *Del. C.* § 1518(2) (1991), which provides for mandatory indemnification in a narrower set of cases: "The partnership must indemnify every partner in respect of payments made and personal liabilities reason-

ably incurred by him in the ordinary and proper conduct of its business, or for the preservation of its business or property."

[2] Section 17-108 is also broader than the statutory indemnification provision applicable to corporations, 8 *Del. C.* § 145 (1991) (requiring "success on the merits"). In fact, Section 17-108 defers completely to the contracting parties to create and delimit rights and obligations with respect to indemnification and advancement of expenses. The statute itself creates no rights to indemnification.

The ESLP Partnership Agreement implements Section 17-108 as follows:

> 6.07(a) The General Partner *and its Affiliates shall be indemnified* by the Partnership from and *against any losses*, judgments, liabilities, amount paid in settlement of any claims and expenses entered against, incurred or sustained by them *in connection with the Partnership*, provided that *the same were not the* result of willful misconduct, recklessness or gross negligence of the General Partner or its Affiliates or the breach of any fiduciary obligation imposed hereunder or by law on the General Partner or its Affiliates.

(Emphasis added).

From this broad mandatory provision, the elements of a valid indemnification claim under the ESLP Partnership Agreement can be derived:

1. Is the claimant the General Partner or its Affiliate?
2. Has the claimant incurred a loss or liability?
3. Has this liability been sustained "in connection with the Partnership?"

If the answer to each of these is in the affirmative, then the claimant has a right to indemnification of such loss or liability by ESLP unless the following question is answered affirmatively:

4. Is that liability the result of willful misconduct, recklessness or gross negligence . . . or the breach of fiduciary duty?

[3] In construing contractual language under DRULPA conferring rights of indemnification, courts should interpret language so as to achieve where possible the beneficial purposes that indemnification can afford. Those benefits include the allocation of certain risks at the outset of a contractual relation in order to make the contractual structure feasible or more attractive to participants. *Cf. Hibbert v.*

Hollywood Park, Inc., Del. Supr., 457 A.2d 339, 344 (1983); *Essential Enterprises Corp. v. Automatic Steel Products, Inc.*, Del. Ch., 164 A.2d 437, 441-42 (1960).

(b) *Application of these provisions to the undisputed facts of this case.*

1. *The claimants are the general partner and its affiliates.*

Each of the defendants meets the first requirement for indemnification. Spectacular is the general partner of ESLP (*see* Partnership Agreement Section 16.01(b)) and the others are affiliates of the general partner.

Section 16.01(d) defines "Affiliates" as follows:

> "Affiliates" shall mean any person *performing services on behalf of the partnership* who: (1) directly or indirectly controls . . . the General Partner; or (2) *owns or controls 10%* or more of the outstanding voting securities of the General Partner; or (3) *is an officer, director*, partner, or trustee of the General Partner . . . . (emphasis added).

Defendants McManus and Green are, therefore, affiliates of Spectacular by application of Section 16.01(d)(3). They are directors of Spectacular and performed services "on behalf of the partnership" by controlling the partnership, contracting with RCMH for the production of the Easter Show, and distributing the profits to the limited partners.

Although as a party to the Production and License Agreement RCMH sought to be accorded the status of an independent contractor, it nevertheless performs services on behalf of the partnership. Those services include all of the principal business activities of ESLP: producing the Easter Show, presenting the Easter Show in New York, and producing financial data for the general partner.

All of these services constituted action taken on behalf of ESLP. The fact that the extent of RCMH's obligation to act on behalf of ESLP was set forth in a separate contract entered at the same time as the Partnership Agreement does not mean that RCMH was not an Affiliate as defined in Section 16.01. Indeed, RCMH as the only shareholder of the general partner is the only entity that could be contemplated by Subsection (d)(2) of Section 16.

Finally, if RCMH is not an affiliate of Spectacular then no one other than Green and McManus can be an affiliate. But that result would contradict not only Section 16.01(d)(2) but would be incon-

sistent with Section 14.01 of the Partnership Agreement which states that "[t]he General Partner, its officers, directors and Affiliates, are currently engaged in other activities, both for their account and for others . . . ." The term Affiliates, as used in this section, is a clear reference to RCMH.

2. *The claimants have incurred liabilities.*

The record is clear that Spectacular, RCMH, Green and McManus have incurred several hundred thousand dollars in legal expenses in defending the litigation instituted by plaintiffs. The settlement statement for the 1992 Easter Show indicates that defendants' various law firms submitted bills aggregating approximately $980,000 from June 1991 to June 1992 alone.

3. *The liabilities sustained by defendants were incurred "in connection. with" ESLP.*

All defendants incurred substantial liabilities for legal fees in the course of resisting claims by the limited partners of ESLP that they have breached various duties owed to the limited partners and ESLP. These expenses were incurred in defending actions taken (or allegedly failed to be taken) in connection with the mounting, presentation and accounting for the Easter Show in New York and in connection with the possible development of a tour that plaintiffs claimed was an important part of the business of ESLP. Thus, these expenses were plainly incurred in defending action taken "in connection with the Partnership."

4. *The expenses incurred by claimants were not the result of willful misconduct, recklessness, gross negligence or a breach of fiduciary duty by defendants.*

Except for one relatively insignificant item of damage in the amount of $3,200, all of the claims asserted in the Dissolution Litigation were dismissed after a lengthy trial on the merits. The large expenses imposed on defendants to defend their actions were not in any material respect the result of any willful misconduct, recklessness, gross negligence or breaches of fiduciary duty. Therefore, as this is my considered view, it follows that, in my opinion, defendants have satisfied the requirement that their indemnified losses were not the result of any such misconduct on their part.

* * *

[4] Thus, since defendants Spectacular, RCMH, Green and

McManus have, in my opinion, satisfied all the contractual conditions on their right to indemnification, Section 6.07(a) of the Partnership Agreement will require ESLP to indemnify them for their legal fees and expenses. I turn now to the question that plaintiff presses: whether the Partnership Agreement permitted ESLP to advance these payments.

II.

While it therefore appears that defendants will be entitled to require ESLP to indemnify them for the expenses they incur in the Dissolution Litigation, whether they may require ESLP to *advance* these expenses presents a separate question. *See, e.g.*, *Citadel Holding Corp. v. Roven*, Del. Supr., 603 A.2d 818 (1992); *Advanced Mining Sys., Inc. v. Fricke*, Del. Ch., No. 11,823, Allen, C. (Aug. 4, 1992). On this question, I conclude that defendants have met the conditions for advancement of expenses set forth in the Partnership Agreement.

(a) *Defendants are legally entitled to require ESLP to advance them their indemnification payments.*

The prerequisites that defendants must satisfy in order to require ESLP to pay indemnification in advance are contained in the second half of Section 6.07(a) of the Partnership Agreement. That Section provides as follows:

> In the event that any action, suit or proceeding is instituted against the partnership or the General Partner or its Affiliates *with respect to the business*, assets, liabilities *or activities of the Partnership*, the General Partner, its Affiliates and the Partnership may each obtain separate legal counsel and other expert assistance to defend . . . any such action, suit or proceeding. *The General Partner or its Affiliates shall have advanced to them by the Partnership out of Positive Cash Flow* and Liquidation Proceeds, as hereafter defined, *otherwise available for distribution to the Partners*, at their request, *funds for payment of all expenses and costs reasonably incurred in connection with the defense of any action*, suit or proceeding *only if*: (1) such action, suit or proceeding relates to the performance of duties or services by the General Partner or its Affiliates on behalf of the Partnership; and (2) the General Partner or its Affiliates, as the case may be, undertakes to repay the advanced funds to the Partnership, without interest, if it

is determined that a General Partner or its Affiliates is not entitled to indemnification hereunder. (emphasis added).

In light of the existence of the Dissolution Litigation, the question of entitlement of the defendants to advancement of their costs of defense of that litigation turns on the questions (1) whether that action relates to the performance of duties or services by the General Partner or its Affiliates "on behalf of the Partnership" and (2) whether the General Partner and its Affiliates have provided an undertaking to repay the advanced funds, if they are found not to be entitled to them.

1. *The legal action for which defendants seek indemnification is related to the performance by defendants of services on behalf of the partnership.*

Defendants Spectacular, McManus and Green were sued for allegedly breaching their fiduciary duties to plaintiffs by mismanaging ESLP. The claims against them arose out of their actions relating to the Partnership most notably the (alleged) failure to exploit the Easter Show in New York, and to exploit its elements in road shows or otherwise.

Defendant RCMH was sued principally because of its role in these same alleged failures. RCMH's role in this effort, however, legally speaking, arose directly from the Production and License Agreement in which it acquired rights and duties with respect to the production and presentation of the Easter Show in New York. Insofar as plaintiffs sought to make RCMH liable for alleged failures to exploit "road show rights," they apparently did so, in part at least, on the theory that RCMH as the controlling parent of Spectacular, owed them fiduciary duties as well. *See In re USACafes L. P. Litig.*, Del. Ch., 600 A.2d 43 (1991).

Plaintiffs argue that the phrase "on behalf of" indicates that advancement of indemnification expenses is only permitted when the services concerning which litigation was filed were performed by the defendant as part of an agency or partnership relationship with ESLP. Here they say RCMH was acting not as an agent or partner but as an independent party under the Production and License Agreement. In support it cites a provision of the Partnership Agreement stipulating that RCMH is not a partner. Thus, plaintiffs argue that RCMH was not acting on behalf of ESLP and is not entitled to advancement.

Nothing in the language of the ESLP Partnership Agreement supports this restrictive interpretation of the advancement obligation to "Affiliates" under Section 6.07(a).

I conclude that the term "on behalf of" was intended by the parties to have its common and ordinary meaning which I understand to be "at the request of and for the benefit of." *J.C. Penney v. Commissioner of Economic Sec.*, Minn. App., 353 N.W.2d 243, 246 (1984). The activities pursued by RCMH that were the subject matter of the litigation vitally concerned the operation of ESLP and the Easter Show in New York. These activities were undertaken by RCMH at the request of and for the benefit of ESLP, albeit pursuant to a separate contractual understanding. It is clear that the broad indemnification rights of Section 6.07(a) and the broad definition of "Affiliate" in Section 16.01(d) of the Partnership Agreement were negotiated and documented as part of the same transaction in which RCMH undertook, in the Production and License Agreement, to assume broad managerial responsibility for the work that would form the core of the partnership's business. All of these agreements are in some respects interrelated. Surely it would be erroneous to construe Section 6.07(a) to exclude from activities that are "on behalf of" ESLP, all those activities required by the Production and License Agreement. That agreement is the main source of duties with respect to ESLP of the principal "Affiliate" of the General Partner. To accept plaintiffs' reading of Section 6.07(a) would be to substantially destroy the parties' efforts to extend advancement rights to a principal affiliate that was specifically intended to be included, as Section 16.02(d)(2) demonstrates.

Thus, in my opinion, all defendants have satisfied the first condition of their right to require ESLP to advance them their legal fees and expenses.

2. *All defendants have provided the required undertaking to repay the advances they have received should they be found not to be entitled to indemnification.*

Plaintiffs urge that defendants did not provide an undertaking "to repay the advanced funds" and are, therefore, not entitled to advancement. ESLP Agreement § 6.07(a).

As set forth below, it is clear that now, and since May 1992, such an undertaking has been in place. Thus, if all other aspects of the advancement question are resolved in defendants' favor, it is the case that at this moment (and since May 1992) defendants do have

the legal right to require ESLP to advance their reasonable costs of defense of the Dissolution Litigation. Moreover, since the undertaking contemplated by Section 6.07(a) is designed to protect the partnership's right to recover the funds advanced, when and if it is determined that indemnification rights are not available and since there was in retrospect no occasion prior to May 1992 for ESLP to conclude that defendants were not entitled to indemnification, it follows that the absence of an undertaking, for a temporary period, would not be a defect that would support substantial relief now, when rights of advancement have been properly invoked.

More fundamentally, however, I cannot accept that any defect in the original grant of advancement rights (prior to May 1992) gives rise to any right to recovery. Let me set forth the few relevant facts.

The Dissolution Litigation was filed on April 5, 1991. RCMH and Spectacular began to incur liabilities for legal fees almost immediately. In late June 1991, RCMH and Spectacular received their first advance of indemnification payment. In the June 28, 1991 settlement statement for the second Easter Show, Spectacular reported a reserve of $250,000 to defray legal expenses. At that time RCMH and Spectacular had incurred legal bills and expenses in the amount of $219,000.

In an August 9, 1991 response to an inquiry from the limited partners, defendants' counsel stated: "[B]y this letter we confirm that Radio City Music Hall Productions, Inc. and Spectacular Partners, Inc. undertake to repay any sums advanced to them pursuant to [section 6.07] should they be obligated to do so under the partnership agreement." (Complaint Ex. C). There is no record of an earlier undertaking. Thereafter, ESLP advanced legal expenses of defendants until approximately October 1991, when RCMH did so for the account of ESLP.

On May 21, 1992, RCMH, Spectacular, Green and McManus each executed an undertaking addressed to ESLP and Spectacular promising "to repay any advanced funds to the Partnership [ESLP] if it is determined that I am not entitled to indemnification under the Partnership Agreement." (Defendants Green and McManus had become defendants in the litigation on October 28, 1991.) Thus, on May 21, 1992, RCMH and Spectacular cured any defect in the undertaking provided by them on August 9, 1991 and all defendants provided a timely undertaking for the advances they obtained in June 1992 and thereafter.

In June 1992, the next settlement for the annual Easter Show was made. That settlement reflects the payment by ESLP to RCMH of the amounts RCMH had paid to defendants' attorneys.

The principal argument regarding the adequacy of defendants' undertaking to repay advances that has any arguable merit is plaintiffs' claim that the undertaking provided by RCMH and Spectacular on August 9, 1991, was defective and, as a result, the advancement of funds made prior to May 21, 1992, was unauthorized. Plaintiffs argue that this undertaking was ineffective because it was made to the limited partners and not to the partnership itself. In effect, plaintiffs argue that Spectacular should have given the undertaking to ESLP (i.e., to itself, as general partner) rather than to the limited partners, even though it was profits to which they would otherwise be entitled that were being diverted to fund the contested advances.

The giving of an undertaking to ESLP itself, or to Spectacular as its general partner, would have been formally clearer and more conventional. But was the letter of defendants' counsel to the limited partners adequate? This question turns on the question whether it would function; that is, whether ESLP, or the limited partners derivatively, could sue on it in the event it was determined that the conditions for indemnification had not been satisfied. For if it is sufficient to create the obligation, it is all that is necessary.

There is no claim that the attorney who "confirmed" that defendants "undertake to repay" was not authorized to bind these principals. Nor was the undertaking communicated to a stranger with no interest in the matter. The limited partners to whom it was delivered did claim the residual right to partnership income and, thus, it was their economic interest that was most affected. I can conceive of no reason why a court would fail to recognize the right of the limited partners to sue derivatively on the August 9, 1991 undertaking. Therefore, I must conclude that it satisfies the requirement of Section 6.07(a) for advancement of indemnification payments.

Accepting all of this, nevertheless, it remains the case that even before the August 9, 1991 undertaking ESLP funded advances. In June 1991, it did so to the extent of less than $219,000.[1] The most plausible explanation of this is simple oversight that extended for six weeks or so. But in any event, given the purpose of such undertakings, neither ESLP nor the limited partners suffered any financial ill effects from the lack of an enforceable undertaking for those weeks.

Indeed as stated above given the length of time that even expedited litigation of the Dissolution Litigation consumed, and given

1. On that date legal fees of $219,000 were paid by ESLP but some part of these fees were incurred in connection with non-litigation matters.