steps to achieve the highest available price in the sale of the enterprise. It is undisputed that defendants have not sought out alternative means to "maximize" the value of the limited partnership interests; indeed defendants assert a right under the Partnership Agreement not to do so. Second, plaintiffs assert that even if there were no special duty to get the highest available value for the limited partners, defendants still would be violating their fiduciary duty, because they offer a low price in circumstances designed to force the limited partners to tender. In support of this theory, they offer expert opinion on value and a number of arguments respecting claims of "coercion." Defendants assert that the price offered is a reasonable one developed after consultation with a retained expert. More fundamentally however, defendants assert that the offer is not coercive. Plaintiffs could accept or reject the offer without harsh or even undesirable consequences. Thus while people will disagree over what is a good or a fair price, the price offered here cannot be thought to violate a fiduciary duty, according to defendants. Third, plaintiffs assert that the disclosures made in the tender offer are misleading, and incomplete in material respects.[3]

I. Background Facts

Following are the facts as they appear to be for purposes of this motion.[4]

A. *The Parties*

The Partnership is engaged in the business of hotel ownership and operation. Marriott MHP Two is the general partner. It is a wholly owned subsidiary of defendant Host Marriott Corporation ("Host") and all of the officers and directors of Marriott MHP Two also serve as officers

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[3]Plaintiff Cary W. Salter commenced the present action on April 24, 1996. At about the same time, on April 23, 1996, plaintiff MacKenzie Patterson Special Fund 2, L.P. ("MacKenzie") commenced an action in the Circuit Court for Montgomery County, Maryland, asserting essentially the same claims. MacKenzie filed an application for expedited discovery and briefing with the Maryland court the following day. The Maryland court, however, had not ruled on the application as of May 6, 1996, and MacKenzie then dismissed the Maryland action on that date and, along with plaintiff George Wasserman, filed suit in the Chancery Court the following day. The two cases were consolidated for all purpose on May 22, 1996 and the MacKenzie complaint was deemed the operative complaint.

[4]I rely for the most part on undisputed facts. I point out when facts are in dispute, but factual disputes may not finally be resolved on a motion of this kind. However, for the limited purpose of protecting the status quo in appropriate circumstances, the court may make reasonable predictions about the relevant facts and law that will apply.

or employees of Host. Plaintiffs Cary W. Salter, Jr., MacKenzie Patterson Special Fund 2, L.P., and George Wasserman are each limited partners of the Partnership.

Defendant Host owns over 90 lodging properties that are operated under Marriott brand names and are generally (but not exclusively) managed by Marriott International, Inc. ("MII"), a corporation formerly affiliated through ownership with Host. Defendants Bruce F. Stemerman, Robert E. Parsons, Jr., William E. Einstein, and Christopher G. Townsend are officers and directors of the general partner (Marriott MHP Two) and also officers of Host.

B. *The Formation of the Partnership*

Host formed the Partnership and sold 745 limited partnership units in it in 1988. The following hotel properties, all of which were subject to very long term management contracts with Marriott International, Corp., were transferred to the Partnership: (1) the New Orleans Marriott Hotel, with approximately 1,300 rooms, (2) the Marriott Rivercenter Hotel in San Antonio, with approximately 1,000 rooms, (3) the Bishop Ranch Marriott Hotel in San Ramon, California, with approximately 370 rooms, and (4) a 50% limited partnership interest in a partnership that owns the Santa Clara Marriott Hotel, with approximately 750 rooms (collectively, the "Hotels"). The management contracts with Marriott International are renewable by that entity for approximately forty years. Marriott International was at the time of the original investment by the limited partners, but no longer is, affiliated with Host.

The aggregate purchase price of the Hotels was $319.48, of which $74.5 million was raised through the sale of limited partnership interests. Limited partnership interests (or units) were distributed pursuant to a Private Placement Memorandum dated January 9, 1989. The 745 units sold were at a stated price of $100,000 each.[5] The remainder of the acquisition price was financed with $266 million in mortgage debt and a $752,000 contribution from Marriott MHP Two Corporation.

The Partnership was structured to narrowly define the rights acquired by limited partners. First, it provided that partnership units could not be sold without the consent of the general partner, who could refuse consent in its "absolute discretion." Nevertheless, it was contemplated that the rights to cash flow that was distributed to limited partners could be assigned without consent. Second, the Partnership

[5]If the investment was made immediately in full it was approximately $90,000. If made over a three year period, the price was $100,000.

Agreement identified the general partner and provided that the limited partners had no power to remove it from that position, excepting circumstances in which it breaches its fiduciary duty. Third, limited partners have very few other voting rights (indeed it is not disputed that there have been no occasions for a vote of limited partnership units during the life of the investment). Generally, voting rights of limited partners were limited to certain extraordinary transactions and except under circumstances involving breach of duty or wrongdoing by the general partner, limited partners could not vote on and approve amendments to the Partnership Agreement or a liquidation of the Partnership without consent of the general partner.

The Partnership Agreement contemplated an ongoing investment that legally could continue in place for almost a century. Plaintiffs say that they were lead to believe that the plan was to liquidate the Partnership by Host selling or otherwise monetizing the Hotels in approximately ten years. The offering memorandum contained illustrative figures showing a "refinancing distribution" after ten years, but the Partnership Agreement does not expressly require that step. The Private Placement Memorandum, reflected illustrative projected cash distributions projections on a per unit basis (based upon certain assumptions): $7,948 in 1990, $11,607 in 1991, $13,211 in 1992, $14,648 in 1993, and $9,357 for the years 1994 through 1998. These projections were expressly based on an assumption that the general partner would make a distribution of "excess refinancing proceeds" of $60,420 per unit in 1993 and a distribution of $150,436 per unit in sales proceeds from liquidation of the Partnership and sale of the Hotels in 1998. These projections further assumed a hotel operating profit (not including the 50% owned hotel) of $34 million in 1990, $38 million in 1991, $42 million in 1992, $44 million in 1993, and $53 million per year from 1994 through 1998.

Apparently, the Hotels have been more profitable than originally projected. To date, the Partnership has recognized hotel operating profits of $52 million in 1991, $56 million in 1992, $57 million in 1993, $59 million in 1994, and $64 million in 1995. Also, through 1995, the Partnership paid out a total of approximately $75,000 per unit in cash distributions (compared to the projected amount of distributions during this period of about $66,000). Vodola Reply Aff. ¶21.

C. The Tender Offer

As early as 1994, Host began considering the acquisition of the limited partner units or alternatively one or more of the Hotels owned by

the Partnership. A variety of potential structures were considered and discussed by representatives of Host, its counsel, and an investment banking firm.[6] By the summer of 1994, Host decided to pursue an acquisition structured as a cash tender offer for not less than 50.1% of the outstanding limited partnership units. Host retained American Appraisal Associates ("AA") to render an opinion on the fairness of the terms of the proposed offer. Although the board of directors authorized the making of the offer, Host subsequently decided not to pursue the offer because "financial resources had been committed to other acquisitions of lodging properties and additional financing sources were not available on acceptable terms."

After senior management changes at Host in October 1995, however, Host decided to pursue the tender offer again. Host again retained American Appraisal Associates and on October 27, 1995, AA presented the results of its preliminary analysis to Host. Sometime prior to actually commencing the Tender Offer in April 1996, Host extended the Partnership's mortgage debt from March 1996, when it became due, to September 1996.

On April 18, 1996, Host, through MHP II Acquisition Corporation (an acquisition vehicle), commenced the Tender Offer to purchase any and all of the 745 outstanding units of the Partnership at $125,000 a unit. The offer was conditioned upon the tender of at least 50.1% of the units and certain amendments to the Partnership Agreement[7] and would expire on May 15, 1996. As of May 15, 1996, however, only about 30% of the limited partner units had been tendered and Host then decided to extend the offer until June 13, 1996. Then, by letter dated May 23, 1996, Host raised the tender price to $150,000 per unit.

In connection with the tender offer. Host distributed an Offer to Purchase describing the tender offer in detail. The Offer to Purchase stated that the purpose of the tender offer was for Host "to acquire control of the Partnership" and that the result of the consummation of the

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[6]Although Marriott MHP Two did not participate in these discussions, officers and directors of Marriott MHP Two who serve as officers of Host participated in the structuring discussions in their capacities as officers of Host.

[7]The amendments would permit Host to vote (through Marriott MHP Two and MHP II) on all matters affecting the Partnership (except for interested transactions) that require the consent of a majority of the limited partners. Host would therefore then have control over those matters. The amendments also would revise certain non-substantive provisions in order to execute the Tender Offer; these changes include such modifications as eliminating the provision that prohibits the transfer of 50% or more of the units in a 12 month period and revising the provision that permits transfers only on the first day of a fiscal quarter.

Tender Offer will be "control by [Host] of most voting decisions." With respect to the effect of this voting power, the following was disclosed:

> This voting power will permit [Host] to control most voting decisions and decide such matters as the timing of the liquidation of the Partnership, a sale of all of the Partnership's properties (to an entity other than [Host or a Host-affiliate], a merger or other extraordinary transaction. This voting power could (i) prevent non-tendering Unitholders from taking action they desired but that [Host] opposed and (ii) enable [Host] to take action desired by [Host] but opposed by non-tendering Unitholders. Consequently, as the owner of at least a majority of the outstanding Units, [Host], through [MHP II], could make decisions or take actions concerning the Partnership that may not fully reflect the interests of all of the limited partners.

The disclosure also listed certain matters which would be controlled by Host, including: having the Partnership acquire additional hotels or sell one or more hotels to an unrelated party, incurring Partnership debt that may cause limited partners to recognize taxable gain, continuing the Partnership beyond its term or dissolving it, issuing additional units of the Partnership, and causing the Partnership to merge or consolidate with another entity.

The Offer to Purchase further disclosed that the terms of the offer were established by Host and "not the result of arm's length negotiations between [Host] and the Partnership," and that Marriott MHP Two "has not retained any unaffiliated person to represent the Unitholders." It also indicated, however, that Host had hired American Appraisal Associates and that American Appraisal had rendered an opinion that the terms and conditions of the Tender Offer were fair from a financial point of view to the limited partners.

The limited partners were informed that Host "currently has no plans to liquidate or dissolve the Partnership." And with respect to refinancing the mortgage debt, it disclosed that the financing the general partner (Marriott MHP Two) was currently considering "would likely have a term of approximately 10-11 years, substantially restrict the ability of the Partnership to sell the Hotels...during the term and prohibit the Partnership from prepaying any debt during the term without paying a substantial premium." Finally, it was disclosed that the successful completion of the tender offer would result in "termination of the partnership for federal income tax purposes."

II. The Legal Standard

[1] The remedy of a preliminary injunction is granted only when the plaintiff demonstrates (1) that he has a reasonable probability of ultimate success on the merits of the claim, (2) that he faces a risk of irreparable injury if he must wait until final judgment in the ordinary course, and (3) that in balancing the equities and respective hardships that a preliminary injunction may cause or prevent, the balance favors plaintiff. *E.g.*, *Katz v. Oak Indus. Inc.*, 508 A.2d 873, 878 (Del.Ch., 1986); *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1341 (Del.Supr., 1987).
[2] It is the burden of the plaintiff to establish that the conditions for the issuance of a preliminary injunction have been satisfied.

III. Decision

A. Summary:

[3] I first note the significance of operating within the context of rather highly specified rights of this limited partnership. As Vice Chancellor Steele recently had occasion to note in the context of fiduciary duty claims arising from a limited partnership:

> A court should assume that parties involved in commerce who elect to join together in a business organization to pursue an enterprise have substantial knowledge of a wide range of business operational frameworks. One can further assume these parties make a thoughtful election with full knowledge of the significance of the operational framework they chose.

In Re Cencom Cable Income Partners, L.P. Litigation, C.A. 14634 (Del.Ch., Feb. 15, 1996) at 9. Thus where the parties have a more or less elaborate statement of their respective rights and duties, absent fraud, those rights and duties, where they apply by their terms, and not the vague language of a default fiduciary duty, will form the metric for determining breach of duty.
[4-6] Giving due attention to the specific terms of this investment, it is my judgment that plaintiffs have failed to establish their entitlement to the remedy of a preliminary injunction. With respect to plaintiffs' "Revlon" theory it is my preliminary view that it will fail, because the rights that the limited partners acquired in this investment do not include a right to determine who manages the assets of the Partnership or how

they are managed. It is the right to direct the management of the firm's assets that gives rise to the phenomena of control premia. *See Mendel v. Carroll*, 651 A.2d 297 (Del.Ch., 1994). Since the limited partners of this partnership do not and were never intended to control management of the assets of the Partnership, there is no substantial source of synergistic value in any third parties' aggregating these claims. Defendants reserved in the Partnership agreement the right to control management of the firm and even to veto "in its absolute discretion" transfers of limited partnership interests. These reserved rights are wholly inconsistent with a fiduciary duty to approve the sale of limited partnership interests to others or to search for others who would offer more. *Cf. Bershad v. Curtiss-Wright Corp.*, 535 A.2d 840 (Del.Supr., 1987).

[7] With respect to the claim that the tender offer is coercive and thus is a self-interested transaction as to which defendants cannot show that the price is fair, I conclude, again provisionally as a motion of this sort contemplates, that plaintiffs have failed to show that the tender offer involves actionable coercion. While the very structure of every 'any and all' tender offer that is *announced to be followed by a merger* involves some structural elements that will at the margin incline some class members to accept a transaction that they might not accept if they owned all the class interests (or if coordination among class members was instantaneous and costless), the structure here does not do so. The unit holders are not given the choice, in effect, $150,000 now or $150,000 some months from now, as would likely be the interpretation of a "two step" any and all tender offer. Here there appears to be no consequence that compels unitholders to tender. Indeed the history of the transaction reflects this fact. The first proposal of defendants was $125,000 and it attracted acceptances from only 30% of the units. That transaction was precisely as coercive" as the present one.

[8-9] It is a different question to ask whether the tender offer is at a fair price. The standard law is that if a tender offer is on full information, and does not entail coercion then the fairness or adequacy of the price is a question left to the business judgment of the parties. *See Lynch v. Vickers Energy Corp.*, 351 A.2d 570, 576 (Del.Ch., 1976); *rev'd on other grounds*, 383 A.2d 278 (Del.Supr., 1977); *Solomon v. Pathe*, 672 A.2d 35, 39-40 (Del. Supr., 1996). But even if one were to conclude at trial that the conditions were present to find an obligation to offer a "fair price" to the class of unitholders *and* one were to conclude that the $150,000 price offered did not represent a fair price given the nature of the financial interest and the projected net cash flows etc., an award of money damages would be a perfectly suitable remedy. The nature of the financial interest involved belie plaintiffs' assertion that only the specific

remedy of requiring a shopping of alternatives can remedy their threatened loss.

[10] Finally, with respect to the claim that the defendants have mislead plaintiffs in the tender offer, I conclude below, again provisionally for purposes of this motion only, that plaintiffs have failed to show an instance in which it appears at this stage that the tender offer document is misleading or incorrect. Indeed it is notable that there was no discovery in this case and all of the matters that are presented as disclosure problems appear to have been developed by plaintiffs largely, if not entirely from the tender offer document.

Below I address each of these conclusions in a little more detail.

B. "Revlon" or Sale of Control Theory:

Plaintiffs contend that defendants have breached fiduciary duties owed to the limited partners by failing to solicit possible alternative transactions prior to commencing its tender offer. Since the tender offer would result in control passing from the unitholders to defendants, plaintiffs argue, defendants have an obligation to fully inform themselves of all alternatives reasonably available and to take reasonable steps to determine the viability of those alternatives so that the unitholders can realize the best value on their interests, including remuneration for the control transferred.

Plaintiffs argue that upon a successful consummation of the tender offer, defendant will obtain control over several matters currently requiring the consent of (but not under the sole control of) the limited partners. Notable among these are liquidation, sale of assets and other extraordinary transactions, and certain transactions with tax implications. Plaintiffs go on to allege that despite ceding their veto rights over these and other transactions, the limited partners will not receive any premium reflecting the control obtained by the acquirer of their partnership units.

[11] The fundamental question that this "*Revlon*" theory raises is what alternative to the pending tender offer are possible *given the explicit terms of the investment made by the limited partners.* That is, the limited partnership agreement recognizes a right in the general partner (who was interested in the Marriott businesses and tradename in multiple ways) to veto any transfer of the units "in its absolute discretion". To assume that the general now has a fiduciary obligation that requires it to locate and approve of a sale to a third party would require a complete Judicial nullification of a negotiated term of the investment. As indicated earlier, absent fraud or similar culpable acts, courts will not ignore the legal effect of negotiated obligation under the rubric of fiduciary duty.

Fiduciary duties provide an essential service in the legal regulation of organizational forms, but they cannot properly be deployed to nullify express agreements absent fraud or similar behavior.

Stated differently, one can see how the specific terms of this investment are inconsistent with the premise of the change in control duties recognized most importantly in *Paramount Communications v. QVC Network*, 637 A.2d 34 (Del.Supr., 1993). The terms of the investment make it appear presently that the tender offer does not involve a transfer of "control" in any meaningful degree. The degree of "control" here held by the limited partners consists principally of limited rights to vote on certain extraordinary transactions (*e.g.*, acquiring new hotels, mergers) and amendments that change the tax treatment of the partnership. While perhaps not insignificant (there has never been an occasion to vote in this Partnership, but on the other hand defendants do seek to exercise these votes if it closes on its tender offer), the voting rights held by the limited partners *do not extend to the right to control corporate assets and ability to change management* more typically associated with a control premium. Here, the general partner possesses the exclusive right to manage the partnership and the limited partners do not generally have the right to remove the general partner. Moreover, the right to manage the Hotels themselves belongs, by the terms of a long-term management agreement, to Marriott International. Thus the limited partners have essentially no substantial right to control the deployment of the Partnership's assets and no right at all that is transferable without the consent of the general partner who may without consent in its absolute discretion. The very slight, indeed practically speaking non-existent, rights of control that went with the limited partnership interests presumably were reflected in the price paid for the investment.

C. Substantive Fairness and Coercion

Coercion: Plaintiffs allege that defendants' conduct in connection with the tender offer threatens to coerce the limited partners into tendering their shares. Plaintiffs explain that defendants' conduct reflects three types of coercion: *opportunity loss*, or depriving the unitholders of the opportunity to select a superior alternative; *substantive coercion*, or inducing a unitholder to mistakenly accept an underpriced offer; and *structural coercion*, or disparate treatment of non-tendering shareholders. The "substantive coercion" idea is essentially a rehash of disclosure arguments. For the reasons discussed below, I find this argument unavailing. Discussed above is the substance of the opportunity loss argument, *viz.* the loss of an opportunity for a control premium, and have

similarly found it unconvincing. I am left then to assess the structural coercion argument.

Structural coercion refers to the threat that after a successful tender offer, a nontendering individual will face some unfavorable consequence that she could have avoided by tendering her interest. Thus the presence of this fact tends to some degree to move members of a class faced with a choice to opt to avoid that effect. Plaintiffs assert that it is a breach of fiduciary duty for a fiduciary to deliberately arrange things so as to coerce its *cestui que trusts* in this way and it is asserted that that is what defendants have done.

Plaintiffs argue that structural coercion results from multiple factors: (1) the commitment of the general partner to a business plan that locks in their capital for an additional ten year period, (2) the fact that closing of this tender offer will have tax consequences for both tendering and non-tendering unit holders, and (3) the loss of the capacity of the unit holders to control the vote, independently of the general partner, whenever a vote may be called for. Together, they mean that a unitholder cannot rationally refuse the offer made. Thus plaintiffs argue that the threats to their interests if the tender offer closes are too great to permit a unitholder to do anything but accept the offer.

As to a concern that the general partner has or will elect to continue to operate the Partnership and do so in a way that decreases cash flow to limited partners, that "threat" is not a consequence of the tender offer, but of the general partner's contractual authority. In all events, the general partner is and will be bound by its fiduciary duty in exercising its powers.

The loss of effective class voting power is another claimed threat faced by nontendering unitholders. How great is this 'coercive' effect? I note that while after closing, the general partner will be able to exercise certain powers previously subject to the veto of the limited partners, those voting rights will now effectively be held by the general (1) whose principle means of legitimately extracting income from the cash flow of the partnership *will be through its limited partnership holdings* and (2) will be subject to the fiduciary duty in all events. One doesn't know what the imaginative brain of counsel or of concerned clients might imagine to support or inflame "coercion" effects, but I cannot regard as established in the record at this stage, an actual threat to the investment interests of the limited partners from the general partner's acquiring a majority of the limited partnership interests.

Plaintiffs also contend that upon consummation of a successful tender offer the Partnership will in effect be terminated and reconstituted for tax purposes, which will have tax recognition consequences, pushing

some holders to sell. I don't doubt that the tax consequences of this transaction, standing alone, may at the margin (large or small I don't know) incline some holders of units to take the cash now. But I cannot conclude that the tax implications that flow as a matter of course from the proposed transaction does constitute actionable coercion. It is simply the tax consequence of this sort of transaction. To hold that the collective action effect of the tax constitutes a reason why a fiduciary can not extend an any and all offer would sharply reduce the availability of transactions of this type. Beyond that generality, there is nothing in the record at this time that suggests that the tax laws were manipulated (or rather that the deal was manipulated in light of the tax laws) by a fiduciary to benefit itself at the expense of the limited partners. On the contrary, arguably, the transaction is a welcome opportunity to some, in spite of the acceleration of tax that it may occasion.

Thus, in sum, I am unable to conclude at this time that defendants have unfairly manipulated their offer in order to create and have succeeded in creating a significant coercive effect upon the interest holders.

Unfair Price: Related to the assertion that this is a non-voluntary transaction is the claim that it is at a bargain price. These claims are related in a couple of ways but most basically by the fact that if the transaction is seen as non-voluntary, then plainly, the fiduciary would act under a duty only to pay a fair price in the tender offer. For purposes of this motion, as set forth directly above, I do not accept the "coercion" characterization. Plaintiffs do not rest their fair price argument entirely on this basis, however. They assert that the transaction is self-interested in the sense that it results in the fiduciary controlling the asset. While I am not sure what additional ground for the fair price claim really survives a determination of voluntariness of the tender offer, I need not rest decision of this point at this stage on that ground.

[12] I want to reserve judgment on the question whether this general partner, in the circumstances of this partnership, in which it has, in effect, retained an absolute right to veto sales of limited partnership interests to others; to control deployment of the assets; and not to be removed (except for breach of fiduciary duty) has an obligation to offer a "fair price" in any dealings with limited partners. For these purposes I might assume that defendants have such a duty. Nevertheless, the existence of any such duty would not justify the enjoining of the tender offer because (1) plaintiffs have not sufficiently shown a probable breach of that duty and (2) in all events damages could be later determined to remedy any violation of duty later established.

D. Disclosure Issues:

[13] It is unquestioned that, in extending an offer to the limited partners to buy their limited partnership units the general partner owes a duty of full disclosure of material information respecting the business and value of the partnership which is in its possession. *See generally*, ALAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG & RIBSTEIN ON PARTNERSHIPS §6.07 (1994); *Shell Petroleum, Inc. v. Smith*, 606 A.2d 112 (Del.Supr., 1992). The legal test for materiality is that identified by the Supreme Court of the United States in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976), and adopted by the Delaware courts in *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 944 (Del.Supr., 1985).

> An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.... It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.

426 U.S. at 449; *see also Zirn v. VLI Corp.*, 621 A.2d 773, 778 (Del.Supr., 1993).

It is this test that one must attempt to apply on this motion in a preliminary way, although it is quite evidently a always a factual matter and thus especially difficult in this context.

1. Cash Flow Misrepresented

[14] I turn first to plaintiffs' allegation that the tender offer does not disclose that the price fails to reflect the increased cash flow of the Partnership, because the general partner has used the increasing cash flow not in the business or to distribute returns but to stockpile cash in order to facilitate the tender offer. Thus plaintiffs see defendants as starving the limited partnership of returns that could and should be made to them in order to await Host's acquisition of a substantial interest in the

Partnership so that Host can participate in these distributions. This theory is denied, of course, by defendants. But insofar as it is put forward as a disclosure theory, I note simply that it is the sort of confessional disclosure that the law does not require, until it is proven. Moreover, I note that plaintiffs' theory only makes sense if it is linked to a claim that the price offered is low. That is, if Host is offering a fair price, taking into account the existence of (disclosed) accumulated cash, plaintiffs' theory offers no explanation as to why Host would rationally pursue the course it posits. In this regard then, plaintiffs' theory reduces to a claim about the fairness of price.

According to plaintiffs, the improving financial outlook of the Partnership is evident from the Partnership's financial statement included in the tender offer, but the same is "not meaningfully disclosed" to the unitholders. One cannot be sure what plaintiffs mean by "meaningfully" disclosed but plaintiffs have failed to persuade me at this juncture that the financial operations of the partnerships is not fully and fairly described according to standard accounting conventions, in the tender offer document.

2. Partnership Value Misrepresented in the Fairness Opinion

Plaintiffs also contend that the defendants failed to disclose 'essential' financial information concerning the Partnership's value, including its liquidation value or its value as a going concern. This information is pertinent, according to the plaintiffs, because it would enable a "reasonable investor" to calculate the actual profits and financial benefits to be gained by defendants from their acquisition of effective voting control.

Plaintiffs also allege that the tender offer document does not disclose that American Appraisal's fairness opinion, which is disclosed in the tender offer, failed to consider that approximately $53 million (more than $71,000/unit) would be available at the time of the tender offer for distribution to the limited partners without considering the proceeds from the sale of the Hotels. (Defendants contest this assertion, stating that it results from a simple-minded and incorrect deduction from disclosed financial information). It is further asserted that the appraisal undervalued the Hotels and failed to disclose that a liquidation of the Hotels would yield to the Limited Partners $100,000/Unit more than the original Offer price, and also failed to disclose that the Hotels had sufficiently appreciated in value to enable the Partnership to refinance its mortgage debt and to distribute excess proceeds to the limited partners. Defendants also allegedly failed to disclose that, based on the Hotels'

current cash flow, the limited partners could receive a distribution of almost double their original investment while allowing them to continue to participate in the appreciation of the real estate. According to the plaintiffs, this information is material because the prospect of such a distribution motivated plaintiffs to invest in this Partnership in the first place.

This, according to the plaintiffs, is again illustrative of a "concerted course of conduct," not disclosed in the tender offer, to depress the value of the units (which it will be recalled do not trade) and withhold distributions to limited partners, in order that defendants may attempt to purchase more than 50% of the units at what plaintiff sees as a bargain price.

With respect to these disclosure claims I am of course unable to adjudicate them on this motion. On this motion I can only assess probabilities, recognizing that where a claim is made out with a sufficient degree of likelihood that additional or corrective disclosure is a more useful remedy than a later damage action. Nevertheless, I am required to state that plaintiffs have failed to persuade me preliminarily that there is a defect in the disclosures made.

* * * *

In summary, I am not persuaded that there is a fundamental impropriety in the offer by the general partner to become a dominant investor in the Partnership. For those who prefer to hold their investment, the fact that the general partner will, if the deal closes, receive a share of distributions chiefly in its role as limited partner may indeed offer some assurance not previously available. The theories of plaintiffs that the general partner has intentionally arranged matters (*i.e.*, the recent opportunity to refinance) in a way to push limited partners to sell, and that, in the context of this Partnership Agreement, it has an obligation to pay to limited partners a fair price and has violated that obligation, are matters that may be litigated hereafter. The application for an injunction against closing of the tender offer or effectuation of an amendment to the Partnership Agreement, if authorized, will be denied.

It is so Ordered this 12th day of June 1996.

MOORE BUSINESS FORMS, INC. v. CORDANT HOLDINGS CORP.

Nos. 13,911 & 14,595

Court of Chancery of the State of Delaware, New Castle

June 4, 1996

Plaintiff, a minority stockholder in the defendant corporation, challenged the forced repurchase of plaintiff's shares by the corporation under provisions of a stockholders' agreement and the subsequent refusal to seat plaintiff's designated director to the board. One of the defendant directors, an attorney, refused in deposition to answer questions involving communications with other defendant directors on matters pertaining to the repurchase, invoking the attorney-client privilege. The plaintiff filed a motion to compel discovery.

The court of chancery, per Vice-Chancellor Jacobs, granted the motion to compel discovery, holding that (1) plaintiff's director was contractually entitled to receive the same information as the defendant directors, and (2) the attorney-client privilege did not bar plaintiff's director from access to information disclosed to all other directors. The court held that, where defendants failed to contract for confidentiality protections in the shareholders' agreement or to address confidential matters in a special committee, the right of plaintiff's director to equal access to information could not be diminished. Finally, the court held that plaintiff's director did not, by voluntarily recusing himself from certain board meetings, waive his right to board information.

1. Corporations ⇐ 297, 400

A director is entitled to information imparted to any other director, where the director's position is derived entirely from his status as a shareholder's designee, and the relationship between the shareholder and the corporation is defined by a stockholders' agreement which does not limit the right of access to information.

2. Corporations ⇐ 319(7)
Witnesses ⇐ 204(2)

A corporation cannot assert the attorney-client privilege to deny a director access to legal advice furnished to the board during the director's tenure.

3. Corporations ⇐ 297, 400

A director's legal right of equal access to board information may be diminished only by an *ex ante* agreement among the contracting parties.

4. Corporations ⇐ 297, 400

Where no factual basis exists on the record to distinguish a director's right of access to board information from those of any other director, the director's right of equal access is not diminished.

5. Corporations ⇐ 297, 400

A director's right of equal access to board information is not diminished where parties to a shareholders' agreement are alleged to have had a tacit understanding that certain board information fell outside the scope of the director's information right, yet no evidence of such an agreement is adduced.

6. Corporations ⇐ 297, 400

Where a potential conflict of interest between a director-designee and the rest of the board is apparent, yet the parties contract for no express limitations on access to board information in a stockholders' agreement, the right of equal access to board information by the director-designee is not diminished.

7. Witnesses ⇐ 199(1)

Because the attorney-client privilege belongs to the client, it would be perverse to allow the privilege to be asserted against the client.

8. Corporations ⇐ 400
Witnesses ⇐ 198(1), 204(2)

Where an attorney renders legal advice to a board of directors, the attorney-client privilege may not be asserted against a member of the board who has the same status as any other member.

9. Corporations ⇐ 400

A board of directors may restrict access to information regarding certain board matters by appointing a special committee empowered to address the matters in confidence. DEL. CODE ANN. tit. 8, § 141 (1991 & Supp. 1996).

10. Corporations ⇐ 400

Where a special committee empowered by the board of directors to address matters in confidence retains separate legal counsel, communications with that counsel are protected from disclosure to directors outside the committee.

11. Corporations ⇐ 297, 400

A director's right of access to board information is not waived where the director voluntarily recuses himself from a board meeting with the understanding that no board action would be taken in his absence, and where the director was provided with unredacted minutes of the board meeting.

12. Corporations ⇐ 319(7)

To find that a director had agreed to waive the right of access to board information, defendants must adduce evidence of a clear understanding to that effect.

13. Witnesses ⇐ 204(2)

A motion to compel discovery is granted against an assertion of the attorney-client privilege, where the privilege is asserted by a corporation against one of its own directors regarding board communications made in the director's absence and where the director's

right of access to board information was not limited by express contractual agreement.

Richard D. Allen, Esquire, and Katherine R. Witherspoon, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware; and Steven S. Rosenthal, Esquire, and Kenneth W. Irvin, Esquire, of Morrison & Foerster, Washington, D.C., of counsel, for plaintiff.

Edward M. McNally, Esquire, Henry N. Herndon, Esquire, and Joseph C. Schoell, Esquire, of Morris, James, Hitchens & Williams, Wilmington, Delaware; John C. Keeney, Jr., Esquire, of Hogan & Hartson, L.L.P., Washington, D.C., of counsel; and Stephanie A. Wood, corporate counsel, Cordant, Inc., Reston, Virginia, of counsel, for defendants.

JACOBS, *Vice-Chancellor*

The plaintiff, Moore Business Forms, Inc. ("Moore"), brings this action to challenge the defendants' repurchase of Moore's Preferred Stock in Cordant Holdings Corporation ("Holdings"), and to contest Holdings' refusal to seat Moore's designee to the Holdings' board of directors. Named as defendants are Holdings, its wholly-owned subsidiary Cordant, Inc. ("Cordant"), and certain Holdings directors.[1]

Pending is the plaintiff's motion to compel certain discovery of the defendants and their counsel relating to the legal advice given to Holdings' board of directors concerning the challenged decision to repurchase Moore's Preferred Stock. The defendants claim that information is protected by the attorney-client privilege and by work product immunity, and accordingly, have resisted the plaintiff's motion.

For the reasons stated below, the plaintiff's motion to compel discovery will be granted.

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[1]The defendant directors are Peter Kusek ("Kusek"), Kenneth Michlovitz ("Michlovitz"), Kenneth Casazza ("Casazza"), Gilbert Decker ("Decker") and Robert Jeffers ("Jeffers"). In March 1990, Cordant was known as Centel Federal Systems, and Holdings was named CFSI Holdings Corporation. In December 1992, Centel Federal Systems and CFSI Holdings Corporation were renamed Cordant and Holdings, respectively. Messrs. Kusek, Michlovitz and Casazza are Cordant's corporate officers, and Messrs. Decker and Jeffers are non-management directors of both Cordant and Holdings.

I. FACTS

To understand the issue presented, a brief summary of the underlying facts is required. Except where indicated, the pertinent facts are undisputed.

In March 1990, Holdings' management created Holdings as a vehicle to effectuate the management buy-out of Cordant (the "Holdings MBO"). The Preferred Stock Purchase Agreement (the "Purchase Agreement") outlined the terms of the Holdings MBO's financing whereby Moore invested $11 million in exchange for all outstanding shares of Holdings' Series B Noncumulative Convertible Redeemable Preferred Stock (the "Preferred Stock"). Moore thereby became Holdings' largest single shareholder, owning (on an as-converted basis) roughly 37% of Holdings' outstanding shares.

In that transaction, Moore also entered into a business development relationship with Holdings and Cordant (the "Strategic Alliance") in which Moore, Cordant and Holdings would work together to identify and develop certain business opportunities. The Purchase Agreement provided that the Strategic Alliance would last at least four and a quarter years; thereafter, either Moore or Holdings would be entitled to terminate it. Section VII.F of the Purchase Agreement provided that Holdings could terminate the Strategic Alliance by repurchasing Moore's Preferred Stock at fair market value on 60 days notice. "Fair market value" for that purpose would be determined in an appraisal by a "big eight" accounting firm selected by Holdings' independent directors.

In the transaction the parties also entered into a stockholders agreement (the "Stockholders Agreement") which entitled Moore to designate one director each to the Holdings and Cordant boards. Under the Stockholders Agreement, Moore's designee served "at will," and could be replaced by Moore at any time. The Stockholders Agreement also entitled Moore to additional board representation if there were any changes to increase the size of the Cordant or Holdings board. The Stockholders Agreement did not restrict in any way the right or authority of Moore's designee as a director of Holdings or Cordant.

During the relevant time period, Mr. Ronald Rogers ("Rogers") was Moore's designated representative on both the Cordant and Holdings board. During that same period, Mr. Robert Jeffers, a partner with the Washington, D.C. law firm of Hogan & Hartson LLP, was designated by Holdings' management to serve as an independent director on both boards. Mr. Jeffers was well acquainted with Holdings from his prior

service as counsel for Cordant, Holdings, and their predecessor corporations.

On February 23, 1994, the Holdings board's two independent directors (Messrs. Jeffers and Decker) engaged KPMG Peat Marwick to establish a fair market appraised value for Holdings' Preferred Stock. After KPMG Peat Marwick completed its valuation, the defendants began negotiations with Chase Manhattan Bank of Maryland for a commitment to finance a potential repurchase of Moore's Preferred Stock shares. These two actions — the engagement of KPMG Peat Marwick to value Moore's Preferred Stock shares, and the negotiations with Chase Manhattan Bank to finance a possible Preferred Stock repurchase — were disclosed to all Holdings directors except Mr. Rogers. Moore was also kept in the dark about these actions.

On August 30, 1994, Cordant and Holdings gave Moore formal notice that Holdings was exercising its contractual right to repurchase Moore's Preferred Stock. Shortly thereafter, the defendants tendered $4.48 million, which was the "fair market value" repurchase price determined by KPMG Peat Marwick in its appraisal. Moore rejected the defendants' tender, taking the position that the defendants had not adequately complied with the requirements of the Purchase Agreement to effect a legally valid repurchase of Moore's Preferred Stock.

As earlier noted, Mr. Jeffers was serving as a member of both the Cordant and Holdings boards. From December 1993 through August 1994, Mr. Jeffers and his law firm furnished the Holdings directors (except Mr. Rogers) legal advice about the Purchase Agreement, and also discussed with them strategies to carry out the termination of the Strategic Alliance. Mr. Jeffers did not inform Mr. Rogers of his legal advice to the other Holdings directors, because (as Mr. Jeffers testified in his deposition) "[n]umerous contracts. . .being negotiated between Moore and Cordant" would have been jeopardized if Moore knew that its interest in Holdings might soon be repurchased. Mr. Jeffers Dep., p. 151.

During Mr. Jeffers' deposition, Moore's counsel asked Mr. Jeffers specific questions regarding the legal advice he gave to Holdings and its directors between March 1990 (when the Purchase Agreement was signed) through August 1994 (when Holdings purported to terminate the Strategic Alliance). Because the defendants asserted the attorney-client privilege, Mr. Jeffers declined to answer. Privilege claims were asserted in response to questions concerning Mr. Jeffers' legal advice relating to Holdings' rights and obligations under the Purchase Agreement, the negotiations with Chase Manhattan Bank to finance the repurchase, the valuation report prepared by KPMG Peat Marwick, the decision not to disclose these actions to Mr. Rogers and to Moore, and a memorandum

from Mr. Kusek to Holdings' directors (other than Mr. Rogers) discussing the repurchase.

Concerned that the defendants will raise similar privilege objections in the forthcoming depositions of other key witnesses, Moore asks this Court to determine that the attorney-client privilege and work product immunity[2] are inapplicable, and to compel the defendants to respond to the contested discovery.

II. THE PARTIES' CONTENTIONS

The defendants contend that the matters in issue are not discoverable for two reasons. First (defendants claim), Moore lacks standing to seek discovery of that information because the only party with even arguable standing is Mr. Rogers, because of his status as a Holdings director. Second (defendants argue), even Mr. Rogers would not be entitled to information relating to the Strategic Alliance because: (i) the contracting parties had a tacit understanding that such information fell outside the scope of Rogers' information right as Moore's director-designee, (ii) the disputed information is protected by the attorney-client privilege, and (iii) even if the contested information is not privileged, by Mr. Rogers' recusing himself at the Holdings board meetings when the Strategic Alliance was discussed, he (and Moore) waived whatever right they may have had to that information.

The plaintiff, Moore, responds that (a) it is entitled to the same information to which Mr. Rogers, its designee, would be entitled as a director of Holdings, and (b) Mr. Rogers was entitled to all information furnished to the other Holdings board members, all of whom were identically situated. Relying upon the Stockholders Agreement and Delaware case law, Moore argues that a corporation may not assert the attorney-client privilege against its own directors, or any of them, to preclude access to matters discussed at board meetings. Moore further contends that Mr. Rogers' self-recusal during board discussions of the Strategic Alliance was not intended to waive his right to receive information (including legal advice) presented to the board during those discussions. Nor did his recusal evidence any agreement or understanding that Moore or its designee would not be entitled to

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[2]Although the defendants have objected on the basis of both the attorney-client privilege and the work product immunity, they do not distinguish between, or separately address, those doctrines in their brief. Because neither party has made a separate analysis or argument relating to work product immunity, the Court will analyze the issues solely in terms of the attorney-client privilege, as the parties themselves have done.

information about matters discussed at Holdings' board meetings, including the Strategic Alliance. Therefore, Moore concludes, it is entitled to discover the contested information.

These contentions are now addressed.

III. ANALYSIS

Two issues arise on this motion: (1) is Moore contractually entitled to the same information that Mr. Rogers, as Moore's designee to the Holdings board of directors, would have been entitled to receive; and (2) does the attorney-client privilege, or any independent side agreement between the parties, bar Mr. Rogers from access to the information that was disclosed to all other Holdings directors? For the reasons discussed in Part III.A, infra, the first question is answered in the affirmative, and for the reasons discussed in Part III.B, the second question is answered in the negative.

A. Moore's Contractual Information Right

[1] The relationship between Moore and Holdings is defined by the Stockholders' Agreement. Mr. Rogers' position as a Holdings director derived entirely from his status as Moore's designee pursuant to that Agreement. All parties understood that Mr. Rogers would be acting as Moore's representative on the Holdings Board and that his tenure as a director would be at Moore's pleasure. The Stockholders Agreement cannot reasonably be construed otherwise. Nothing in the Stockholders Agreement precludes Moore from receiving any information imparted to Mr. Rogers. It therefore follows that if Mr. Rogers was entitled to the disputed communications by virtue of his position as a Holdings director, then Moore would also be entitled to these communications by virtue of the Stockholders' Agreement. Therefore, the question becomes: what were Mr. Rogers' information rights as a director of Holdings?

B. Mr. Rogers' Information Rights As A Director

1. The Applicability Of The Attorney-Client Privilege To Mr. Rogers

Moore contends that Mr. Rogers, as a Holdings director, was entitled to the same right of access to board information as all other Holdings directors. Moore relies upon the Stockholders Agreement, as well as Delaware case law holding that a corporation may not assert the

attorney-client privilege against its own directors to deprive them of access to information discussed at board meetings, including legal advice furnished to the board. The defendants, on the other hand, maintain that they have a legal right to withhold disclosure of that attorney advice from Moore and its designee, Mr. Rogers, because it related directly to Holdings' contractual relationship with Moore -- an issue as to which Mr. Rogers and Moore had an interest in conflict with the remaining Holdings directors.[3] I conclude that in these circumstances, Moore's position is clearly correct.

[2] First, Delaware case law supports Moore's position that as a general matter, a corporation cannot assert the privilege to deny a director access to legal advice furnished to the board during the director's tenure. See Kirby v. Kirby, Del. Ch., C.A. No. 8604, Berger, V.C. (July 29, 1987); AOC Ltd. Partnership v. The Horsham Corp., Del. Ch., C.A. No. 12480, Chandler, V.C. (May 4, 1992); See also In Re Fuqua Industries, Inc. Shareholder Litigation, Del. Ch., Consol. C.A. No. 11974, Chandler, V.C. (Oct. 8, 1992). Those authorities are appropriately applicable here.

In Kirby, three persons claiming to be the corporation's directors sued (inter alia) the remaining directors and the corporation. The plaintiffs sought discovery of legal advice that had been provided to the corporation during their tenure as directors. The Court held that the plaintiffs were entitled to discover that legal advice, because "(the) directors are all responsible for the proper management of the corporation, and it seems consistent that they be treated as the 'joint client' when legal advice is rendered to the corporation through one of its officers or directors." Kirby, Mem. Op. at 16.[4] See also Gottlieb v. Wiles, D.Colo., 143 F.R.D. 241, 247 (1992) (corporation cannot assert the attorney-client privilege against a former director for legal advice provided during his tenure); Harris v. Wells, D.Conn., 1990 WL 150455, at 3-4 (Sept. 5, 1990)(citing Kirby with approval and holding that a

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[3]The defendants maintain that there was a conflict of interest between Moore's director-designee, Mr. Rogers, and the remaining Holdings board members, because a decision to terminate the Strategic Alliance would have been detrimental to Moore's business interests, and a disclosure that the defendants were contemplating that step would have adversely impacted Holdings' ongoing negotiations with Moore on other contracts. Therefore, the defendants conclude, the invocation of the attorney-client privilege against Mr. Rogers (and Moore) to shield communications relating to terminating the Strategic Alliance was essential to protect Holdings' business interests.

[4]Although the Kirby Court described the directors as a "joint client," a more accurate description of the relationship is that there was a single "client," namely, the entire board, which includes all its members. That is, a director seeking information furnished to the board that is the subject of the privilege claim is a "client" not in his or her individual capacity, but as a member of the collective body (the board) of which the director is one member.

director could not assert attorney-client privilege against his fellow corporate directors.)

In AOC Ltd. Partnership, the plaintiff was a limited partnership that owned 40% of the defendant corporation and, indirectly, that corporation's wholly-owned subsidiary. Two of the plaintiff's representatives were directors of both corporations. The plaintiff sued the corporation, its wholly-owned subsidiary, and the individuals who comprised a majority of the parent and subsidiary boards. The plaintiffs then sought discovery of the legal advice that had been furnished to the subsidiary's board. The Court granted the discovery, holding that because the plaintiffs' representatives were members of the subsidiary's board, the plaintiff was as much a "client" for purposes of having access to the attorney's advice as the defendants who were asserting the privilege. AOC Ltd. Partnership, Mem. Op. at 2. This case is strongly analogous to AOC.

The defendants rely upon In Re Fuqua Industries, Inc. Shareholders Litigation, supra, as support for their claim that they were legally entitled to treat Mr. Rogers in a disfavored manner by excluding him and Moore from access to the disputed information. That reliance is misplaced. In Fuqua Industries, a stockholder challenging a merger sought discovery of otherwise privileged information that the acquired corporation had shared with the acquiring corporation. The two corporate defendants claimed that the information was privileged, because they were "joint clients" by virtue of the acquiring corporation's representatives having attended meetings of the acquired corporation's board where the privilege-claim information was discussed. The Court rejected that claim and granted the discovery.

The defendants suggest that Fuqua Industries supports the rule that a board may assert the attorney-client privilege against a stockholder's director-designee in cases where the corporation's interests come into conflict with the interests of the stockholder. Fuqua Industries establishes no such legal principle. Indeed, in Fuqua Industries the claim of privilege was rejected, and the Court's ruling that no "joint-client" relationship existed was a particularized factual determination Id. Mem. Op. at 6. If anything, Fuqua Industries is more supportive of Moore's position than the defendants'. In Fuqua Industries, the acquiring corporation was a small stockholder with no contractual right to board representation; in this case Moore was a substantial stockholder whose

right to representation and participation on the Holdings' board was established by contract.[5]

In short, nothing in Fuqua Industries nor in the instant circumstances justifies creating a broad exception (for which the defendants argue) to the proposition that all directors are entitled to equal access to corporate information furnished to the board.

[3-5] In this case, the only way that Mr. Rogers' legal right of equal access to "board information" could be diminished would have been by an ex ante agreement among the contracting parties. No such agreement was made here. While the defendants claim that the parties separately understood that all Holdings board discussions relating to the Strategic Alliance would be "off limits" to Mr. Rogers and Moore, they adduced no evidence of any such agreement. Therefore, no factual basis exists on this record to distinguish the information rights of Moore's director-designee's from those of the other Holdings directors.

[6] Second, any potential conflict of interest between Moore's director-designee and the rest of the Holdings board concerning the Strategic Alliance was clearly foreseeable at the time the parties contacted to give Moore a right to board representation, and it could have been addressed at that time. From the outset it was clear to all concerned that the Holdings board (which by contract included Moore's director-designee) would have the authority to terminate the Strategic Alliance. The purpose of Moore having representation on the Holdings board was to protect Moore's interests, which were independent of (and, on certain issues could be potentially in conflict with) those of Holdings. That conflict was apparent from the beginning, and had the parties wanted to limit the director-designee's access to information about discussions concerning the Strategic Alliance, they could have easily contracted for those limitations. Neither the Purchase Agreement nor the Stockholders Agreement provided for any limitation on the director-designee's authority.

[7-8] Because the attorney-client privilege belongs to the client, it would be perverse to allow the privilege to be asserted against the client. To adopt the defendants' position would achieve precisely that result. The client in this case is the Holdings board. Mr. Rogers was a member

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[5]The defendants' reliance on Milroy v. Hanson, D. Neb., 875 F.Supp. 646, 649-650 (1995) is also unavailing. In Milroy, the Court found that a director was not entitled to the privilege-claim information because he sued primarily in his capacity as a shareholder. Because the petitioner did not assert his claim in his capacity as a director, he was held to be not entitled to relief in that capacity. 875 F. Supp. at 650.

of that board, having the same status as the other directors. No basis exists to assert the privilege against him or, by extension, against Moore. [9-10] The defendants protest that if the contested information is found to be not privileged, then Holdings "would have been entirely unable to have any privileged communication with its attorney regarding its rights and obligations under the Purchase Agreement." Defendants' Answering Brief at 11. The short answer is that that is not so. Holdings had alternative means to enable its directors (other than Mr. Rogers) to receive confidential attorney advice not discoverable by Moore. Holdings could have bargained for such protections in the Stockholders Agreement. Alternatively, and independent of the Stockholders Agreement, the Holdings board could have acted, pursuant to 8 Del. C. § 141(c) and openly with the knowledge of Moore and Rogers, to appoint a special committee empowered to address in confidence those same matters. Under either scenario the special committee would have been free to retain separate legal counsel, and its communications with that counsel would have been properly protected from disclosure to Moore and its director designee. Neither approach was followed here.

2. The "Waiver" Issue

Finally, the defendants claim that even if Moore had a right, free of any privilege, to the contested information, that right was waived by Rogers recusing himself from the Holdings board meetings whenever issues related to the Strategic Alliance were discussed. The defendants maintain that "[c]onsistent with the parties understanding to their separate interests in the strategic alliance, neither Moore nor its board designee Mr. Rogers was privy to this advice, nor should they have been." Defendants' Brief in Opposition to the Motion to Compel at 5.

[11] This argument fails as a matter of proof. Mr. Rogers recused himself from the various board meetings as an accommodation and for reasons of courtesy, i.e., to enable the other directors to conduct a frank discussion, not by reason of any prior agreement. Rogers Dep. Tr. at 254-255. When Mr. Rogers recused himself from a board meeting, it was with the understanding that no board action would be taken in his absence. Id. at 232. Consistent with that understanding, the Holdings directors always provided Mr. Rogers unredacted minutes of the board meetings, which described the Holdings Board's discussions of the Strategic Alliance in his absence.

[12] For this Court to find (as the defendants assert) that the parties agreed that Mr. Rogers and Moore would not participate in (or be kept ignorant of) an entire category of board discussions pertaining to

Holdings, the defendants must adduce evidence of a clear understanding of that effect. The defendants have submitted no evidence that the parties had ever reached an understanding to limit Moore's right to information about any matter discussed at the board level. More specifically, there is no evidence that the parties understood that Mr. Rogers (and Moore) would not have access to the legal advice provided to the Holdings board about the Strategic Alliance. If anything the record proves the contrary, since the defendants routinely provided Rogers a summary of the contested information in the form of unredacted board meeting minutes memorializing those conversations.

* * *

[13] For the foregoing reasons, the plaintiff's motion to compel discovery will be granted. The parties shall confer and submit an appropriate form of implementing Order.

NRG BARRIERS, INC. v. JELIN

No. 15,013

Court of Chancery of the State of Delaware, New Castle

July 1, 1996

Plaintiff, a Delaware corporation involved in a pending merger, commenced suit regarding a contract dispute concerning a stock purchase agreement where the defendants, stockholders of the corporation, entered into an agreement to sell their stock to a director and shareholder of that corporation. This opinion addresses conflicting cross motions on three discovery issues relating to financial documents, plaintiff's motion to disqualify defendants' counsel, and defendants' motion to dismiss or stay.

The court of chancery, per Vice-Chancellor Steele, concluded that the plaintiff had produced all the documents that exist; that three years was a sufficient period within which production relating to post-transaction value could lead to the discovery of relevant financial

evidence; and that the production of financial documents of the "WSJ Corporations," allegedly improperly organized by William Jelin, would not lead to the discovery of relevant evidence. The court also found that the parties failed to present a sufficiently clear factual background about the defendants' counsel's actual access to information concerning the disputed transaction, and thus reserved decision on the motion to disqualify counsel. Furthermore, the court denied the defendant's motion to dismiss since defendants failed to show (1) that Delaware lacked personal jurisdiction over defendants; (2) that minimum contacts did not comport with due process; and (3) that this was a *forum non conveniens*. The motion to stay was also denied in order to provide efficient and expedited resolution of the dispute in time for the merger to go forward.

1. Evidence ⚿ 368
Pretrial Procedure ⚿ 336, 354, 375

When a party represents that it produced all documents that exist, an order requiring production of more documents will not be entered.

2. Evidence ⚿ 368
Pretrial Procedure ⚿ 336, 375

Three years, dependent on the particular facts, can be a sufficient period within which production of financial documents relating to post-transaction value of stock is relevant.

3. Evidence ⚿ 368
Pretrial Procedure ⚿ 352, 375

Production of financial records concerning unrelated corporations will not be compelled when they were not a subject of the contract at issue, none of the defendants ever owned shares in them, and defendants had foresworn any further investigation at the time of entry into the contract.

4. Attorney and Client ⚿ 21.20
Pretrial Procedure ⚿ 678

A decision on a motion to disqualify counsel will not be made without sufficient factual background and argument by the parties.

5. Corporations ⇐ 665
Courts ⇐ 12(2)

The court may assert personal jurisdiction over defendants under Delaware's long-arm statute. DEL. CODE ANN. tit. 10, § 3104 (1994).

6. Pleading ⇐ 350(7)
Pretrial Procedure ⇐ 512, 681

On a motion to dismiss, only those matters which the parties refer to in the pleadings will be considered.

7. Courts ⇐ 11, 12(2)

Plaintiff bears the burden of establishing personal jurisdiction over the defendants.

8. Courts ⇐ 12(2)

In order to establish personal jurisdiction over defendants, the plaintiff must satisfy a two-prong test: (1) prove defendants' conduct satisfies Delaware's long-arm statute, and (2) establish the assertion of jurisdiction comports with the due process requirements of the Fourteenth Amendment of the United States Constitution.

9. Courts ⇐ 12(2.15)

Defendants who transact any business or perform any character of work or service in the state enable the plaintiff to hail them into the Delaware courts. DEL. CODE ANN. tit. 10, § 3104 (1994).

10. Courts ⇐ 12(2.15)

Transaction of business in Delaware will be found where (1) defendants held shares in a closely-held Delaware corporation; (2) defendants entered into a contract with a Delaware corporation to sell their stock to a director and shareholder of that corporation; (3) the parties expressly agreed that Delaware law governed the contract; and (4) Delaware lawyers participated in drafting the contract and rendered advice assuring that the agreement would comply with the law of the parties' choice.

11. Courts ⇐ 12(2.5), 12(2.15)

Business contact with Delaware will be established where defendants actually sold stock in a Delaware close corporation to a fellow shareholder and director of that corporation, where the corporation in which the stock was sold was intentionally incorporated in Delaware, where the parties to the stock purchase agreement deliberately chose Delaware law to govern the agreement, where Delaware counsel were employed to assist in the process of negotiating the agreement, where a significant portion of the deal was negotiated in Delaware, and where the deal was consummated in Delaware.

12. Courts ⇐ 12(2.5), 12(2.15)

Evidence of a personal, physical presence no longer serves a meaningful purpose in and of itself for determining whether the transaction of business occurred in Delaware.

13. Constitutional Law ⇐ 305(5)
Courts ⇐ 12(2.5)

Before a court may secure jurisdiction over a defendant, that defendant must have certain minimum contacts with the forum such that the maintenance of the suit does not offend traditional notions of fair play and substantial justice.

14. Courts ⇐ 12(2.5)

A defendant must have sufficient ties to the forum state such that the defendant could reasonably expect to be hailed into that state to adjudicate the defendant's legal rights.

15. Contracts ⇐ 127(4)
Courts ⇐ 12(2.5)

Defendants could reasonably expect they would be subject to suit in Delaware as a result of entering into the stock purchase agreement.

16. Courts ⇐ 12(2.5)

The statutory situs of the stock is insufficient to satisfy the minimum contact requirement.

17. Contracts ⇐ 127(4)
Courts ⇐ 12(2.5)

As a consequence of attempting to take full advantage of transacting business here, defendants were on notice that plaintiff could sue them in Delaware.

18. Constitutional Law ⇐ 305(5)
Courts ⇐ 12(2.5)

Where defendants have sufficient minimum contacts in Delaware, should reasonably and fairly expect they would be subject to suit in Delaware, and have shown by their actions to have weighed the burden of litigating in Delaware against the state's interest in adjudicating the dispute combined with plaintiff's interest in obtaining convenient and effective relief, these minimum contacts satisfy due process and allow the court to exercise jurisdiction over defendants.

19. Courts ⇐ 28

The grant of a motion to dismiss by reason of *forum non conveniens* is a rarity which may properly occur only where genuine hardship is present.

20. Abatement and Revival ⇐ 13
Action ⇐ 69(2)

As a general rule, litigation should be confined to the forum in which it is first commenced, and a defendant should not be permitted to defeat the plaintiff's choice of forum in a pending suit by commencing litigation involving the same cause of action in another jurisdiction of its own choosing.

21. Abatement and Revival ⇐ 1
Action ⇐ 67

The decision to stay is one made in the light of all the circumstances in order to determine the best and most economical means of determining the controversy.

22. Action ⇐ 69(2)
Contracts ⇐ 127(4)

Even when out-of-state action is first filed, where there is no clear evidence of proper service of process or progress in the litigation there, and plaintiffs in the out-of-state action chose to make an issue of a contract which explicitly recites that Delaware law governs, they could anticipate appearing before a Delaware court.

23. Abatement and Revival ⇐ 13
Action ⇐ 69(2)

Where Delaware is the only jurisdiction in the circumstances available to and capable of meeting the necessity for orderly and efficient justice, the court will deny a motion to stay based on a claim of first-filed action in another forum.

Jesse A. Finkelstein, Esquire, and Todd C. Schiltz, Esquire, of Richards, Layton & Finger, Wilmington, Delaware; and Robert A. Sacks, Esquire, and Steven W. Thomas, Esquire, of Sullivan & Cromwell, Los Angeles, California, of counsel, for plaintiffs.

David J. Margules, Esquire, of Wolf, Block, Schorr and Solis-Cohen, Wilmington, Delaware, for defendants.

STEELE, *Vice-Chancellor*

On June 27, 1996, the parties presented oral argument concerning three issues: (1) conflicting cross motions on three discovery issues, (2) *Plaintiff's Motion to Disqualify Defendants' Counsel*, and (3) *Defendants' Motion to Dismiss or Stay*. I address these issues below.

The Discovery Issues

[1] Defendants made three motions to compel additional financial information from Plaintiff. Plaintiff has already responded to Defendants' initial request. I denied Defendants' request for an order compelling Plaintiff to produce documents in addition to those already produced relating to NRG's value and financial performance up to the date of redemption of Defendants' shares. Plaintiff represents it produced all documents that exist. I will not enter an order requiring production of documents which do not exist. Should events transpire showing the

additional documents are available, there are mechanisms to deal with the problem when and if they occur.

[2] Defendants also requested an order compelling Plaintiff to produce financial documents beyond the date of redemption. I granted the *Motion to Compel* post-transaction financial documents for three years beyond the date of redemption. I consider three years, under the particular facts of this case, to be a period within which production relating to post-transaction value could lead to the discovery of relevant financial evidence.

[3] Defendants requested an order compelling the production of financial documents of the "WSJ Corporations." William Jelin allegedly improperly organized the WSJ Corporation in a scheme to usurp corporate opportunities in breach of his fiduciary duties to NRG. They were not the subject of the Stock Purchase Agreement in issue, nor have any of Defendants ever owned shares in any of them. Further, for consideration above the price for the NRG stock, Defendants foreswore any further investigation into the circumstances surrounding the formation of the WSJ "affiliated" corporations at the time of entry into the Stock Purchase Agreement. I concluded production of financial records concerning those unrelated corporations would not lead to the discovery of relevant evidence. I denied that motion.

Plaintiff's *Motion to Disqualify Defendants' Counsel*

[4] As the argument went forward, I found the factual record on the *Motion to Disqualify Counsel* to be incomplete. The parties failed to present a sufficiently clear factual background about Defendants' counsel's actual access to information concerning the disputed transaction while an employee of Plaintiff's former counsel. I reserved decision pending the completion of the factual record, the parties' review of ***In re Appeal of Infotechnology Inc.***, Supr. Ct., 582 A.2d 215 (1990), and comments on its applicability. I now understand Plaintiff, by letter to the Court, confirms it can find no factual basis to conclude Defendants' counsel, while an employee of Plaintiff's former counsel, "acquired any confidential information or knowledge about" NRG or the Stock Purchase Agreement of 1989. Nevertheless, Plaintiff continues to contend I should preclude Defendants' counsel and his firm from representing Defendants "under D.R. 1.10." Counsel still decline to discuss the role of the trial judge in relation to the Supreme Court's policy statement in ***Infotechnology***. I expect counsel to state their respective positions on ***Infotechnology*** and address the comment to D.R. 1.10 where the following language appears:

> . . ., the rule of disqualification should not be so broadly cast as to preclude other persons from having reasonable choice of counsel.

Does Delaware endorse a *pro se* rule or a case by case "realistic" approach which the comment apparently endorses? When ***Infotechnology***'s rule is added to the mix, counsel should be able to argue the balance of the practical equities and the effect on the expeditious resolution of this dispute.

Defendants' Motion to Dismiss

[5] Defendants challenged this Court's ability to secure personal jurisdiction over Defendants. Defendants' counsel characterized the issues focusing on personal jurisdiction as "simple." After two hours of oral argument, I conclude the factual and legal positions of the parties to be no more facile than when we convened on Thursday. Defendants' counsel raised several questions concerning *in personam* and *quasi in rem* jurisdiction over Defendants. After listening to the oral argument and reviewing the pleadings, I find this Court does have personal jurisdiction over Defendants under Delaware's long-arm statute, 10 *Del. C.* § 3104 ("Section 3104").[6]

1. Standard for Motion to Dismiss

[6] On a motion to dismiss, Delaware courts only consider those matters which the parties refer to in the pleadings. ***James River-Pennington Inc. v. CRSS Capital, Inc.***, Del. Ch., C.A. No. 13870, Steele, V.C. (Mar. 6, 1995), Mem. op. at 9 (*citing* ***Hart Holdings v. Drexel Burnham Lambert***, Del. Ch., 593 A.2d 535, 538 (1991)). The parties do not seriously contest the facts underlying *Defendants' Motion to Dismiss*. I have also weighed uncontested representations counsel made at oral argument as they relate to the factual contentions of the parties.

2. Personal Jurisdiction

[7-8] At this stage, *Defendants' Motion to Dismiss* relies, in part, on the assertion this Court lacks personal jurisdiction over Defendants. A

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[6]Accordingly, I need not address the issues of *quasi in rem* jurisdiction and jurisdiction under the Directors Consent Statute, 10 *Del.C.* § 3114.

plaintiff "bears the burden of establishing personal jurisdiction over the defendants." ***Van de Walle v. L.F. Rothschild Holdings, Inc.***, Del. Ch., C.A. No. 9894, Steele, V.C. (Aug. 2, 1994), Mem. op. at 3. Here, Plaintiff must satisfy a two-pronged test:

(1) prove Defendants' conduct satisfies Delaware's long-arm statute, and

(2) establish the assertion of jurisdiction comports with the due process requirements of the Fourteenth Amendment of the United States Constitution — the so-called "minimum contacts" requirement.

Plaintiff has met this burden of proof.

[9] Section 3104 provides, in relevant part, "a court may exercise personal jurisdiction over any nonresident, or his personal representative, who . . . "[t]ransacts any business [or performs any character of work or service] in the State." I am convinced Defendants have transacted business in this state enabling Plaintiff to hail them into the Delaware courts.

[10] First, NRG Barriers, Inc. ("NRG") is a closely-held Delaware corporation. Defendants held shares in the corporation. Second, Defendants entered into the Stock Purchase Agreement, a contract with a Delaware corporation to sell their stock in the Delaware close corporation to a director and shareholder of that same Delaware corporation. Third, the parties expressly agreed Delaware law governed the Stock Purchase Agreement. Fourth, Delaware lawyers participated in drafting the Stock Purchase Agreement and rendered legal advice with respect to Delaware law for the express purpose of assuring the parties their agreement would comply with the law of the parties' choice. Surely, none of the parties should be surprised a party to that agreement asks a Delaware court to interpret the agreement after a dispute arose about its meaning. The mix of these related facts constitutes the transaction of business in Delaware.

Defendants argue these events and conditions are insufficient to constitute transacting business in Delaware. They cite the alleged precedent of ***Greenly v. Davis***, Del. Supr., 486 A.2d 669 (1984). In ***Greenly***, the Supreme Court found a Delaware trial court correctly concluded Delaware did not have personal jurisdiction over a Pennsylvania resident who allegedly breached a contract to sell a Delaware corporation. ***Id.*** at 671. The ***Greenly*** plaintiff was interested in purchasing two companies from the defendants who contracted for the sale. ***Id.*** In that case, the defendants, like Defendants here, were not Delaware residents. ***Id.*** at 670. They owned a Pennsylvania corporation and a Delaware corporation. ***Id.*** Neither defendant had ever transacted business in Delaware related to the focus of the dispute in the lawsuit.

Id. The trial court granted a motion to dismiss based upon factual affidavits which established the parties negotiated the agreement in Pennsylvania with no actual consent relating to the transaction of sale in Delaware except "a *part* of the negotiations included a proposed sale of stock of a Delaware corporation which does transact business in Delaware." *Greenly*, 486 A.2d at 671 (emphasis added).

Defendants argue "[t]he *Greenly* defendants' contact with Delaware was "much greater than here, and involved findings that the Delaware corporation, the defendants and the negotiations had actual physical ties to Delaware." *Defendants' Reply Memorandum of Law in Support of Their Motion to Dismiss or Stay* at 3. I disagree. The *Greenly* case is readily distinguishable from the case before me.

[11] Here, defendants actually sold stock in a Delaware close corporation to a fellow shareholder and director of that same Delaware corporation. They sold stock in a corporation intentionally incorporated in Delaware. They deliberately chose Delaware law to govern the Stock Purchase Agreement. They employed Delaware counsel who assisted in the process of negotiating the agreement. In *Greenly*, there existed only the *possibility* of a stock sale; here, it in fact occurred. Moreover, the record in *Greenly* did not indicate a significant portion of the negotiations took place in Delaware, let alone the consummation of the deal. Here, the parties sought Delaware involvement unequivocally. Here, the business contact with Delaware does not derive solely from the mere fact record ownership of shares is in Delaware.

[12] Furthermore, Defendants rely too heavily on "physical ties to Delaware." I find an analytical approach based upon facts denoting physical presence is an increasingly anachronistic methodology for determining whether the transaction of business occurred in Delaware. The advent of superior communications technology lessens the need for face-to-face encounters in the business context. Facsimile machines, video conferencing, electronic mail, and super computing are liberalizing the traditional idea of "transacting business" in Delaware and other states. While evidence of a personal, physical presence — bricks and mortar or sales paraphernalia within the borders of a state — may be helpful in determining a party's intent to transact business and to indicate the actual transaction of business, this concept no longer serves a meaningful purpose in and of itself. The long-arm statute applies.

3. Minimum Contacts

[13-14] Before a court may secure jurisdiction over a defendant, that defendant must have "certain minimum contacts with [the forum]

such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice.'" ***International Shoe v. Washington***, 326 U.S. 310, 319 (1945). A defendant must have sufficient ties to the forum state such that the defendant could reasonably expect to be hailed into that state to adjudicate the defendant's legal rights. ***Shaffer v. Heitner***, 433 U.S. 186, 216 (1977).

[15] Defendants insist such minimum contacts are conspicuously absent from this case. I disagree. Plaintiff has shown there are sufficient minimum contacts to satisfy due process. I find Defendants could reasonably expect they would be subject to suit in Delaware as a result of entering the Stock Purchase Agreement.

Defendants rely on ***Hart Holdings Co. v. Drexel Burnham Lambert Inc.***, Del. Ch., C.A. No. 11514, Allen, C. (May 28, 1992), Mem. Op. to refute Plaintiff's assertion sufficient minimum contacts exist. In ***Hart***, this Court refused to extend personal jurisdiction over the defendants where their only contact was their ownership of stock in Delaware corporations. ***Id.*** at 16. Chancellor Allen wrote,

> where the subject matter of the litigation involves the legal existence of stock in a Delaware corporation, . . . I am convinced that ownership of that stock, without more, will ordinarily be sufficient to satisfy the dictates of common fairness to permit binding adjudication in this court of such claims, without regard to where the holder may reside.

Id. However, Chancellor Allen noted the particular factual situation in ***Hart Holdings*** prevented him from concluding "ownership of shares *itself* is enough to satisfy the constitutional test of minimum contacts." ***Id.*** (emphasis added). Similarly, Defendants rely on ***Istituto Bancario Italiano SpA v. Hunter Eng'g Co.***, Del. Supr., 449 A.2d 210 (1982), ("***IBI***"), to make their point stock ownership is insufficient to show sufficient minimum contacts. They misplace their reliance on ***IBI***. The ***IBI*** holding *assumes* the only tie to Delaware was "the statutory situs of the stock in Delaware . . . ." ***IBI***, 449 A.2d at 222.

[16-17] Here, statutory situs of the stock is not the only connection to Delaware. It is one of many ties satisfying the minimum contract requirement: The Stock Purchase Agreement is a contract with a Delaware corporation and between shareholders who chose to incorporate in Delaware. The agreement details the transfer of stock of a Delaware corporation to a Delaware corporation's director. The agreement specifically calls for the application of Delaware law to govern

disputes arising from it.[7] Delaware lawyers were substantially involved in drafting the agreement. The dispute Plaintiff asks Delaware to resolve does not arise merely from "ownership of stock itself" (I interpret "itself" to mean "alone"), nor statutory situs of the stock in Delaware. The agreement is the basis on which Plaintiff brings this action. Moreover, Delaware is the only forum which can provide relief to NRG before the August 16, 1996 closing date for the merger between NRG and Schuller. The expedited, equitable relief Delaware can provide for the parties is, no doubt, one of the reasons the parties opted for Delaware in the first instance. As a consequence of their attempt to take full advantage of transacting business here, Defendants were on notice Plaintiff could sue them in Delaware.

[18] For the reasons I discussed *supra*, I find Defendants do have sufficient minimum contacts in Delaware. They should reasonably and fairly expect they would be subject to suit in Delaware. *See Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985). They have already, by their actions, weighed the burden of litigating in Delaware against this State's interest in adjudicating any dispute combined with a party-plaintiff to the agreement's "interest in obtaining convenient and effective relief." *IBI*, 449 A.2d at 220. These minimum contracts satisfy due process. It is both fair and reasonable for this Court to exercise jurisdiction over Defendants.

4. *Forum non Conveniens*

Defendants argue the issues before this Court and the California court are the same. They contend *McWane Cast Iron Pipe Corp. v. McDowell-Wellman Eng'g Co.*, Del. Supr., 263 A.2d 281 (1970), compels the conclusion Delaware should yield to California. Plaintiff argues to the contrary — the issues before this Court and the issues before the California court are distinct. Therefore, Plaintiff insists, *McWane* is not dispositive, and a *forum non conveniens* analysis is appropriate. In *Defendants' Reply Memorandum of Law in Support of Their Motion to Dismiss*, Defendants respond with the assertion a *forum non conveniens* analysis demands dismissal, or alternatively a stay, of this

[7]The parties designated possible alternative forums including California, Maine, and New Jersey in the event of litigation arising from the agreement. I agree the parties did so in order to suggest reasonable additional jurisdictions where suit would be convenient. Their enumeration of alternatives implies the parties reasonably anticipated a party-plaintiff choosing a Delaware court to resolve disputes arising from this transaction.

action. They forward this argument in addition to their original contention *McWane* demands dismissal or a stay of the Delaware action.

Even if the issues here and in California were not the same, Delaware should not defer to California. The legal standard for a *forum non conveniens* analysis is well established. *E.g.*, ***Monsanto Co. v. Aetna Cas. & Sur. Co.***, Del. Supr., 559 A.2d 1301 (1988); ***Pavin v. Dorfman***, Del. Supr., 236 A.2d 425, 427 (1967). I need not go through a detailed application of the six traditional factors of a *forum non conveniens* analysis as the personal jurisdiction section, *supra*, reveals. That discussion incorporates the typical fundamental policy issues underlying the *forum non conveniens* criteria analysis.

[19] It may well be the more typical case for examination of the *forum non conveniens* principles lies where a party asked for dismissal of a first filed action. Nonetheless, "[t]he grant of such a motion is a rarity which may properly occur only where genuine hardship is present. (citations omitted)." ***Carlton Inv. v. TLC Beatrice Int'l Holdings, Inc.***, Del. Ch., C.A. No. 13950, Allen, C. (Nov. 21, 1995), Mem. op. at 7. Having recited the record as it presently appears, I find this case does not lend itself to a application of a *forum non conveniens* analysis. The litigation of this case in this jurisdiction will result in no more hardship to Defendants than litigation in California. The *Delaware* Court of Chancery is the proper forum to hear this case.

Defendants' Motion to Stay

I now turn to Defendants' alternative *Motion to Stay*. Defendants argue the California action, which they filed one month before this action, involves the same parties and issues.[8] Accordingly, they believe *McWane* requires I stay this action in favor of the first-filed California action. I agree with the underlying assumptions but disagree with Defendants' suggested conclusion.

[20] In *McWane*, the Supreme Court articulated a strong policy against a defendant forum shopping to frustrate a plaintiff's right to choose the jurisdiction to bring the action. *Id.* at 283. Defendants are correct. The "general rule" is

> litigation should be confined to the forum in which it is first commenced, and a defendant should not be

[8] As I discussed *supra*, for the purpose of my analysis I assume the parties and issues are the same.

> permitted to defeat the plaintiff's choice of forum in a pending suit by commencing litigation involving the same cause of action in another jurisdiction of its own choosing; that these concepts are impelled by considerations of comity and the necessity of an orderly and efficient administration of justice. (footnote and citations omitted).

Id.

[21] It is the orderly and efficient administration of justice that concerns me. Here, equity cannot condone a stay of the Delaware action. Even if the California action and the Delaware action share the same parties and issues, I should not stay the Delaware action. Delaware has too vested an interest in this matter to turn away. I am convinced my conclusion cannot be read to encourage forum shopping. The facts and circumstances of this case simply favor this Court maintaining the action. In ***General Foods Corp. v. Cryo-Maid, Inc.***, the Supreme Court wrote, "The decision [to stay] is one to be made in the light of all the circumstances in order to determine the best and most economical means of determining the controversy." 198 A.2d 681, 683 (1964). Only Delaware is "capable of doing [both] *prompt and complete justice*, involving the same parties and the same issues." *McWane*, 263 A.2d at 283 (emphasis added).

[22] Although the California action is the first-filed, there is no clear evidence of proper service of process or more importantly, on the facts of this case, progress in the litigation there. Plaintiffs in the California action chose to make an issue of a contract which implicitly recites Delaware law governs. For the reasons I discussed *supra*, they could anticipate appearing before a Delaware court.

Moreover, I am not convinced it is Defendants' intention to pursue their claim in California to an end result on the merits. After listening to Defendants' counsel's representations at oral argument and reading correspondence to a non-litigating interested third party, one could reasonably conclude they filed in California to imperil the August 16, 1996 closing in order to pressure Plaintiff and its merger partner to settle Defendants' claims as a price for an unencumbered merger — a merger Defendants vocally conceded at argument to be in the best interest of all parties.

[23] The Court of Chancery can provide efficient and expedited resolution of the dispute in time for the August 16, 1996 merger to go forward. The representations of the parties indicate the California court, particularly with an outstanding request for a jury trial and a claim for

punitive damages, cannot accommodate this "drop dead" date. Our Constitution, statute, rules, customs and tradition designed the Court of Chancery as an appropriate forum to resolve this precise type of dispute and to provide appropriately tailored relief. Delaware is the only jurisdiction, given the exigency of the circumstances, available to and capable of meeting the "necessity for orderly and efficient justice." I am convinced Plaintiff did not file this litigation in order to frustrate Defendants' choice of forum but to assure the consummation of a carefully considered business plan and the corresponding benefits to be realized from it. I am compelled to deny *Defendants' Motion to Stay.*

For the reasons I discussed *supra,* this Court has jurisdiction over Defendants under Section 3104, and Defendants have the requisite minimum contacts in Delaware in comport with due process. The action will continue on the expedited schedule in place.

IT IS SO ORDERED.

SCHWARTZBERG v. CRITEF ASSOCIATES L.P.

No. 14,837

Court of Chancery of the State of Delaware, New Castle

June 7, 1996

Plaintiff Schwartzberg commenced suit against defendants CRITEF Associates Limited Partnership and CRITEF III Associates Limited Partnership (the partnerships) for access to certain business records. Plaintiff is a limited partner of both entities and is a general partner of CRITEF Associates. The sole function of both CRITEF Associates and CRITEF III Associates is to serve as the general partner of two limited partnerships, CRITEF and CRITEF III, respectively, (the funds). The funds act as financial intermediaries, raising funds publicly through the distribution of Beneficial Assignee Certificates (BACs) and investing the proceeds in tax exempt bonds secured by mortgages on multifamily housing properties.

Plaintiff Schwartzberg contacted the partnerships and demanded a list of registered holders of BACs issued by the funds. Plaintiff Schwartzberg also demanded certain financial records concerning the underlying properties securing the bonds held by the funds. Plaintiff said that he requested the information (1) in order to evaluate the fairness of a pending transaction in which, if approved by the BACs will be cashed out and (2) in order to solicit the holders of BACs to replace the partnerships as general partners (in fact to install himself as managing general partner).

The court of chancery, per Chancellor Allen, concluded that Schwartzberg's stated purpose for wanting access to the information he requested - to solicit the BACs holders to replace the partnerships as general partners of the funds — was fundamentally and importantly in conflict with the interest of the partnership and was an improper purpose from the point of view of the partnerships. Accordingly, the relief was denied.

1. Corporations ⇐ 181(1), 181(3), 181(6)

The test to determine whether a partner seeking access to partnership records seeks the records for an improper purpose has two prongs: (1) the records must be personal to the individual seeking access, and (2) the individual's personal reasons for requesting the records are adverse to the interests of the partnership considered jointly. Accordingly, where the sole or predominant reason plaintiff seeks a list of BAC holders and financial records of the properties is (1) to attempt to replace the partnerships as general partners of the funds, and in the process (2) to gain leverage against defendants with respect to other litigation pending between them, the partner meets this improper purpose test. DEL. CODE ANN. tit. 8, § 220 (1991).

2. Corporations ⇐ 181(1)

With respect to statutory sources of inspection rights, the rights of a general partner are broad.

3. Corporations ⇐ 181(1)

It is generally recognized that implicit obligations consistent with the text of written obligations may, and sometimes should, be inferred under both statutes and contracts.

4. Corporations ⇐ 473
Contracts ⇐ 168

A contractual obligation may be inferred when, given the terms of the express contract made and the circumstances of the contracting process, it is more likely than not that if the parties had thought to address the subject, they would have agreed to create the obligation that is under consideration by the court.

5. Corporations ⇐ 181(3), 181(6)

Absent an explicit contractual provision or statutory language to the contrary, and where a partner denying another partner access to partnership business records can show that the partner seeking access is doing so for reasons personal to that partner and adverse to the interest of the partnership, the court is warranted in denying the request for access.

Richard D. Allen, Esquire, William M. Lafferty, Esquire, and Justin M. Miller, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for plaintiff.

R. Franklin Balotti, Esquire, Allen M. Terrell, Jr., Esquire, and Robert J. Stearn, Jr., Esquire, of Richards, Layton & Finger, Wilmington, Delaware; and Deborah L. Thaxter, Esquire, and Sigmund J. Roos, Esquire, of Peabody & Brown, Boston, Massachusetts, of counsel, for defendants.

ALLEN, *Chancellor*

In this action Martin Schwartzberg seeks from defendants CRITEF Associates Limited Partnership and CRITEF III Associates Limited Partnership ("the Partnerships") access to certain business records. Mr. Schwartzberg is a limited partner of both entities and at least in name, a general partner of CRITEF Associates. The sole function of both CRITEF Associates and CRITEF III Associates is to serve as the general partner of two limited partnerships, CRITEF and CRITEF III, respectively ("the Funds"). The Funds in essence act as financial intermediaries, raising funds publicly through the distribution of Beneficial Assignee Certificates ("BACS") and investing the proceeds in tax exempt bonds secured by mortgages on multifamily housing properties.

Specifically in this suit Mr. Schwartzberg seeks from the Partnerships a list of registered holders of BACS issued by the Funds. The Partnerships as managing general partners of the Funds are each said to hold these lists in their possession. Mr. Schwartzberg seeks as well certain financial records concerning the underlying properties securing the bonds held by the Funds. Plaintiff says he seeks this information 1) in order to evaluate the fairness of a pending transaction in which, if approved by the BACS holders, the Funds will be merged into another entity and the BACS will be cashed out and 2) in order to solicit the holders of BACS to replace the partnerships as general partners (in fact to install himself as managing general partner).

In early February 1996, plaintiff sent letters to the Partnerships demanding access to this information. His requests were denied and he initiated this litigation on February 15, 1996. The action was tried on March 6 and 7, 1996.

Under the circumstances presented, I find that Mr. Schwartzberg's stated purpose for wanting access to the information he requests—to solicit the BAC holders to replace the Partnerships as general partners of the Funds—is a purpose fundamentally and importantly in conflict with the interests of the Partnerships and is an improper purpose from the point of view of the Partnerships. Thus whether sought in his capacity as a limited partner of both Partnerships or as a formal general partner of one of them, I conclude for the reasons set forth below that the relief sought must be denied.

I. Facts

Following are the facts as I find them based upon a preponderance of the evidence in the record. Because allegations of improper purpose and of waiver or estoppel have been made, the necessary background facts are elaborate.

A. *The Parties and Related Persons and Entities*

Defendant CRITEF Associates, formed in 1986, is a Delaware limited partnership based in Rockville, Maryland. Its sole purpose is to serve as the sole general partner of Capital Realty Investors Tax Exempt Fund Limited Partnership ("CRITEF"), also a Delaware limited partnership. The limited partners of CRITEF Associates are William B. Dockser, H. William Willoughby, Rockville Pike Associates-IV, and Mr. Schwartzberg. According to the partnership agreement, the general partners of CRITEF Associates are Schwartzberg, Dockser, Willoughby,

and C.R.I., Inc. C.R.I. is a Delaware corporation now owned by Dockser and Willoughby.[1]

Defendant CRITEF III Associates, a Delaware limited partnership formed in 1987, is also based in Rockville, Maryland. It's sole purpose is to serve in the capacity of general partner to Capital Realty Investors Tax Exempt Fund III Limited Partnership ("CRITEF III") a Delaware limited partnership. The limited partners of CRITEF III Associates are Schwartzberg, Dockser, Willoughby, and Rockville Pike Associates-IV. C.R.I. is the sole general partner of CRITEF III Associates.

CRITEF and CRITEF III (as well as the Partnerships) were formed in 1986 and 1987, respectively, in response to changes in the tax laws. The Funds acted as mortgage lenders on eighteen multifamily housing properties; holding tax exempt bonds for which the properties serve as collateral. Although the Funds own the bonds they do not own the underlying properties because such ownership would destroy the tax exempt feature of the bonds. The underlying properties are owned by local "lower tier" partnerships. Although the eighteen properties originally were held in partnerships owned by developers, fifteen of the properties were taken back because they were not meeting their debt service and presently are held in partnerships affiliated with Dockser and Willoughby.

Investments in the Funds were originally sold to the public in the form of Beneficial Assignee Certificates ("BACS") and since 1993, the BACS have been publicly traded on the American Stock Exchange. BAC holders neither own nor have an interest in the underlying properties.

These entities and relationships are graphically represented in the following two diagrams:

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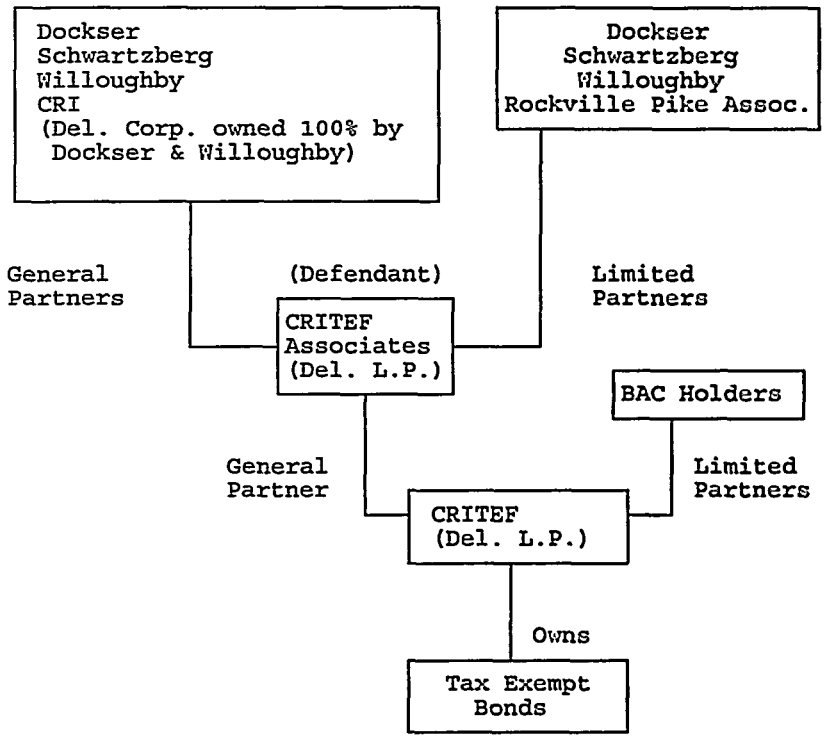
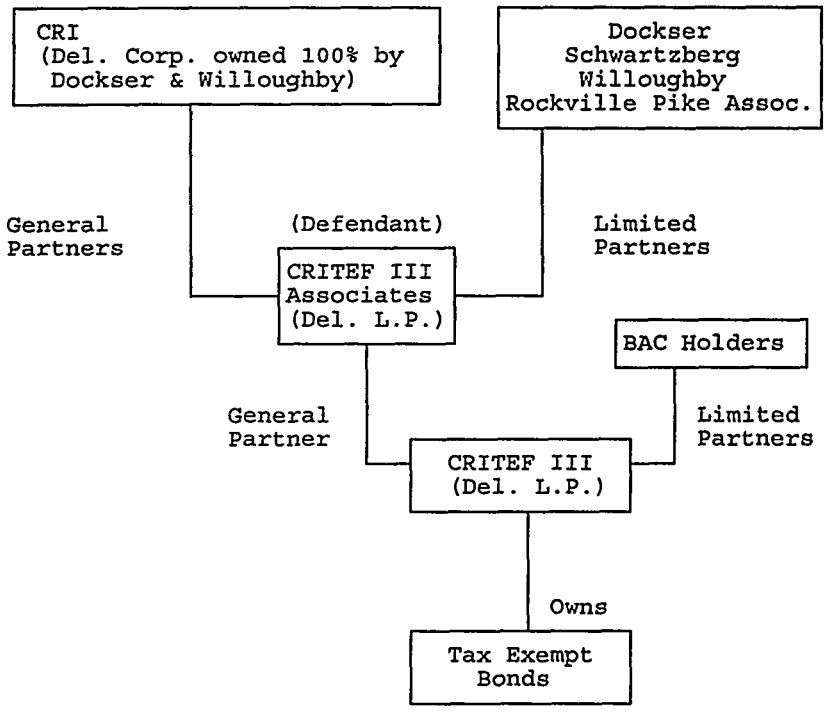
[1]Prior to 1990, Dockser, Willoughby, and Schwartzberg were equal shareholders of C.R.I., a corporation formed to develop, syndicate, and operate entities that invest in real estate pursuant to various tax incentive programs. C.R.I. has sponsored numerous public and private offerings of limited partnership interests in investment partnerships, including the Funds.

Defendant CRITEF Associates



Defendant CRITEF III Associates



B. *The 1990 Buyout*

On January 1, 1990, Mr. Schwartzberg withdrew from the business of C.R.I. and sold his interest in C.R.I. to Mr. Dockser and Mr. Willoughby for approximately $4.5 million. Although Schwartzberg would no longer be active in CRI's business of managing investment partnerships (including CRITEF Associates, CRITEF III Associates, and consequently the Funds), the parties agreed that in order for him to avoid certain tax consequences Schwartzberg would remain designated as a general partner of CRITEF Associates. It was agreed however that he would have neither management power nor liability: As part of the buyout, an Indemnification Agreement was signed that was designed to protect Schwartzberg from liability for "any event that occurs on or after the effective date hereof that is related to the fact that [Schwartzberg] is or was a general partner of [CRITEF Associates]". In addition the parties entered an Agreement for Management Consulting Services pursuant to which Schwartzberg would be paid $100,000 a year for three years for consulting services provided to C.R.I. and the partnerships C.R.I.

managed and an Asset Management Agreement pursuant to which Schwartzberg and a company wholly owned by him (CMS Inc.) would provide property level asset management services for part of C.R.I.'s government-assisted portfolio (which did not include any of the assets of the Funds) over a three-year term. He also remained a limited partner of both CRITEF Associates and CRITEF III Associates.

C. *The Formation of CAPREIT and the Sale of CRICO*

In 1993, subsequent to Schwartzberg's withdrawal from the business, C.R.I. put together Capital Apartment Properties, Inc. ("CAPREIT") as an entity to own and manage multifamily properties. C.R.I. contributed contracts it had acquired to purchase about 25 properties and a management company, CRICO Management Company (including all of its personnel and assets),[2] to CAPREIT. A planned public offering of CAPREIT stock, however, was not accomplished and C.R.I. sought instead to make it a private REIT.

In February 1994, C.R.I. came to agreement with a third party, Apollo Advisors, according to which a new entity affiliated with Apollo—to be named AP CAPREIT—would put money into CAPREIT. Thereafter CAPREIT became a wholly owned subsidiary of AP CAPREIT. As part of the formation of CAPREIT, C.R.I. had retained an earn-out that would allow C.R.I., if certain hurdles were met, up to a 22 percent share of AP CAPREIT. In addition, the sale to Apollo was set up so that if no agreement could be reached as to the value of the management company (CRICO) by June 30, 1995, C.R.I. would have the right to take back CRICO.

By the end of June 1995 C.R.I. had reached an agreement with Apollo and AP CAPREIT about the sale of CRICO. Pursuant to that agreement (the "Redemption Agreement"), C.R.I. sold all of its interest in AP CAPREIT (including CRICO) to AP CAPREIT for $4.75 million; approximately $3.5 million was for CRICO and the remainder for C.R.I.'s carried interest in AP CAPREIT (the earn-out). The agreement also contained a provision for a termination refund. According to that provision, if there are terminations of the management contracts of CRICO, C.R.I. would have to pay back (to CAPREIT directly) some percentage of the original $3.5 million consideration received. The

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[2]CRICO had contracts to manage numerous properties, including the fifteen non-performing properties (of the original eighteen properties that served as collateral for the tax exempt bonds held by the CRITEF Funds) that were being held in the "lower tier" partnerships owned by Dockser and Willoughby.

percentage of the refund is determined according to a formula that provides for decreasing amounts over a certain number of years.

D. *The CRITEF Merger*

Shortly after the Redemption Agreement was reached between C.R.I. and Apollo Advisors, Apollo (through CAPREIT) inquired about acquiring the Funds. By September 1995 CAPREIT and C.R.I. had reached a preliminary agreement subject to the vote of the BAC holders, contemplating a merger in which the BACS would be canceled and the holders paid approximately $150 million. At that time the market capitalization for the Funds was approximately $120 to $125 million and the merger consideration therefore entailed about a 20% premium over the market price.

Pursuant to the proposed merger, CRITEF Associates' and CRITEF III Associates' general partner interests would be transferred to Apollo for consideration. The proceeds from the sale of these general partner interests would then flow to the partners of CRITEF Associates and CRITEF III Associates. Accordingly, Dockser, Willoughby, and Schwartzberg would each receive approximately $250,000.[3]

The merger agreement also provided that CAPREIT would pay C.R.I., approximately $4.5 million, on an outstanding account for accrued mortgage servicing and administration fees owed to C.R.I. Because the mortgage servicing and administration fees were subordinate to the debt service on the bonds, these fees had been accrued when properties became unable to generate interest payments in full. Thus, the accrued fees represented an asset (account receivable) for C.R.I. and a liability (an account payable) for the Funds. Payments on this amount could only occur when and if the interest on the particular property was brought current.[4] In addition, upon consummation of the merger there would no longer be any termination refund payable (the potential give-back

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[3]Each of the general partner's would actually receive $500,000, but one half of Docker's, Willoughby's, and Schwartzberg's interests in CRITEF Associates and CRITEF III Associates had been assigned to the Resolution Trust Corporation in another connection so that each of them stood to receive $250,000 on their own behalf.

[4]Because of a transaction C.R.I. consummated in June 1995 (the "CRIMII MAE transaction"), a portion of these accrued fees were owned by another unrelated public entity, CRIMII MAE, at the time of the proposed CRITEF merger. In June 1995 C.R.I. sold and merged its entire mortgage group in CRIMII MAE which in exchange assumed roughly $9 million worth of debt owed by C.R.I. and gave Dockser and Willoughby shares of CRIMII MAE. The plaintiff has now, in addition to the CRITEF merger, questioned this transaction and threatened to take legal action against it.

obligation would be canceled) under the Redemption Agreement. Of the maximum of $3.5 million that could have become refundable approximately $1.3 million is attributable to CRICO management contracts for CRITEF Fund properties and thus not refundable as a result of the merger.

Not long after the proposed merger was announced in September of 1995, class action litigation was initiated by certain BAC holders in this court. By February of 1996 a settlement of these suits was reached in principle and the merger terms were improved to provide BAC holders an aggregate amount of approximately $158.5 million (an increase of $8.5 million) and to reduce the amount paid to C.R.I. for the accrued fees from $4.5 million to $2 million.[5]

E. *The Budget Dispute*

Although the business relationship between Dockser, Schwartzberg, and Willoughby appears to have been agreeable for the first three years or so after the buyout in 1990, it then began to deteriorate. In July 1995 a disagreement arose concerning Schwartzberg's budget for 1996 (*i.e.*, the budget for his company, CMS Inc.) under the Asset Management Agreement.[6] Mr. Schwartzberg desired that the amount he had received the year before — approximately $1.25 million — be provided under the contract but Mr. Dockser and Mr. Willoughby were unhappy with Schwartzberg's performance. They proposed a base contract with an incentive structure: $500,000 for asset management services, an incentive of up to $750,000 based on fees generated by sales and refinancings, and a 50-50 split of such fees after that. No agreement could be reached and Schwartzberg finally stated that he would initiate litigation if his contract was reduced.

On September 6, 1995 Mr. Schwartzberg met with Mr. Dockser and Melissa Lackey, general counsel of C.R.I. They informed him of the proposed merger and its general terms, including the total amount to be paid to the BAC holders, the sale of the Partnerships' general partner interests, and the settlement of the accrued mortgage servicing fees. Mr. Schwartzberg inquired what his interest in the Partnerships was and

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[5]The agreement to settle the class actions is pending court approval.

[6]Although the Consulting Agreement expired after its three-year term, the Asset Management Agreement was extended twice and now has an expiration date of December 31, 1997. The original Asset Management Agreement provided for a fixed budget but was later amended so that the CMS's budget for the following year would be determined in good faith between the parties based on sales activity.