real estate opportunities. Thus, Marshall, as general partner, had no duty to allocate any management fee or other fee-generating contract to Amerimar Realty. Consistent with its role as an "overhead" entity, Amerimar Realty had only a right to be reimbursed for the cost of any services that it did provide.

Balin insists that the allocation of investment opportunities to persons or entities other than Amerimar Realty was an exception to the norm and occurred only with the consent of Amerimar Realty shareholders. But the evidence does not support that argument. The record shows that all the parties understood that the allocation of management contract opportunities was the result of negotiations between Marshall and Balin, acting as the general partners of Amerimar Associates, L.P.

Nor can Balin credibly claim that the parties intended to structure The Rittenhouse project differently from the arrangement described above. Marshall and Balin contracted to manage the Rittenhouse Condominium Owners Association through a separate entity called Rittenhouse Realty, Inc.. Tr. 974-76. Balin himself referred to Rittenhouse Realty, Inc. as the "registered real estate broker for The Rittenhouse Condominiums." DX 242. That arrangement is inconsistent with, and undercuts, Balin's claim that Marshall and Amerimar Associates, L.P. were required to present all management contract opportunities for acquired properties to Amerimar Realty.

VI. PLAINTIFF'S CLAIMS ARISING OUT OF THE DENVER MANAGEMENT FEES

Balin's final claims concern management fees generated by properties located in Denver, Colorado (the "Denver Fees"). There are two distinct claims. The first is an individual claim by Balin that he is contractually entitled to be paid $250,000 per year from the Denver Fees by Amerimar Realty. The second claim, brought derivatively on behalf of Amerimar Realty, is that Marshall wrongfully diverted the Denver Fees from Amerimar Realty to an entity named ARC-Management.

I conclude that Balin (1) has no entitlement to any guaranteed payment of $250,000 per year, and (2) is precluded from claiming that Marshall diverted funds from Amerimar Realty, because Balin acquiesced in the very fee structure that he now seeks to attack.

A. The $250,000 Contract Claim

1. The Facts

Balin's Denver Fee claims rest on the following facts: In 1985, Marshall and Balin participated in acquiring two properties located in Denver, Colorado. The acquisition arrangement included a Denver Management Fee Agreement that had two separate components. First, an administrative management fee equal to 1% of the gross revenues generated by the Denver property would be paid directly to Ameribass Realty. Second, a separate management fee equal to 4% of the gross revenues generated by the Denver property would be paid directly to a partnership known as Ameribass Realty Management Co.-Colorado ("ARMCO-Co.").

To facilitate the payment of their share of the management fees, Marshall and Balin created ARC-Management Company, Inc. ("ARC-Management") to participate as a partner of ARMCO-Co.. A portion of the management fees would flow from ARMCO-Co. directly to ARC-Management, which would then distribute those monies 75% to Marshall and 25% to Balin, i.e., in proportion to their respective ownership interests in ARC-Management.

Shortly after the Denver properties were acquired, Marshall and Balin, prompted by Robert Bass's request for a larger participation, renegotiated this Denver Fee distribution structure. As a result of that renegotiation, the portion of the Denver Fees that was to flow to ARC-Management was assigned to an entity called Amermbass Realty Management Company-Pennsylvania ("ARMCO-Pa.") whose partners were Ameribass Realty (49%) and ARC-Management (51%). This new arrangement enabled the Denver Fees to be split between Robert Bass (as the controlling shareholder of Ameribass Realty), and Balin and Marshall (as the sole partners of ARC-Management).

For this renegotiated arrangement, Balin and Marshall extracted a quid pro quo: under Sections 4.08(a) and (b) of the ARMCO-Pa. Partnership Agreement, Balin would receive from Ameribass Realty an annual salary of $250,000, plus benefits, and Marshall would receive an annual salary of $300,000, plus benefits. The Partnership Agreement also contains provisions designed to protect Balin and Marshall from a reduction in or loss of those salaries. Section 4.08(d) provides for a $175,000 "priority" payment of the Denver Fees to Ameribass Realty, as a "partial non-accruing reimbursement of Amer[i]bass for the salary and other compensation of Marshall and Balin." PX 40. Sections 4.08(e) and (f) provide that if Marshall's or Balin's salaries were reduced, the Denver

Fees would be allocated, dollar for dollar, to ARC-Management in the precise amount needed to compensate for the salary reduction.

When Robert Bass withdrew from the enterprise in 1987, the parties executed a Master Agreement (DX 343)[18] that restructured all of the real estate investments and partnership interests in which Mr. Bass and his affiliates had participated. Under Section 7.03(a) of the Master Agreement, ARMCO-Pa. assigned to Ameribass Realty all of its rights to participate in the Denver Fees, as well as its correlative obligations.

Balin continued to receive his $250,000 salary until shortly after his termination in April 1992. Since then, Marshall has caused the $250,000 that would otherwise have been Balin's salary to be paid directly to ARC-Management. ARC-Management, in turn, has distributed 75% of those payments to Marshall and 25% to Balin.

2. Balin's Claimed Right to a Guaranteed Priority Distribution of $250,000 Per Year.

In support of his claim of entitlement to receive $250,000 per year, Balin argues that the $250,000 "salary" payments were not a salary, but were in reality a guaranteed priority distribution from the Denver Fees. His argument runs as follows: Even though the ARMCO-Pa. Partnership Agreement was not the legal source of that guaranteed payment, that Agreement did confirm (and was intended to embody) this guarantee. Balin further contends that because the Master Agreement assigned the fees received from ARMCO-Co. to Ameribass Realty, the distribution of fees is no longer governed by the ARMCO-Pa. Partnership Agreement. Rather, it is now governed by the Master Agreement, which mandates that the fees flow directly to Ameribass Realty. Because Amerimar Realty is now the assignee of all of Ameribass Realty's rights and obligations, Amerimar Realty is presently entitled to receive all the Denver Fees that originally flowed to ARMCO-Pa.. Moreover, because Amerimar Realty also succeeded to Ameribass Realty's obligations, Amerimar Realty is obligated to pay Balin's guaranteed distribution of $250,000 per year, plus benefits.

This claim is not supported by the record. The ARMCO-Pa. Partnership Agreement expressly provided that if either Marshall or Balin were terminated, the Denver Fees would flow to ARC-Management. PX 40, at §4.08 (e) and (f). Although Balin asserts that it was "understood"

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[18] ARMCO-Pa. was not a party to the Master Agreement, but the Agreement was signed by all of its partners.

that ARC-Management would continue paying him the $250,000 per year, he has furnished no evidence, other than his own uncorroborated self-serving testimony, of that understanding. Nor did Balin ever mention any such understanding at trial, but he did admit that under the ARC-Management Agreement, fees would be distributed 75% to Marshall and 25% to himself. Tr. 27, 627.

The ARMCO-Pa. Partnership Agreement explicitly describes those payments as salaries. PX 40, at § 4.08(b) ("[Ameribass] shall pay to Balin an annual salary of Two Hundred and Fifty Thousand Dollars ($250,000)") (emphasis added). In his original complaint, Balin characterized those payments as salary, and Amerimar Realty consistently reported those payments to Balin as wages. DX 324, DX 328. There is no objective evidence that the parties ever intended for these payments to be a "preferential distribution" that Balin would receive unconditionally, whether or not he remained employed by Amerimar Realty.

There is evidence that Marshall and others referred to the fee redistribution provisions of the ARMCO-Pa. Partnership Agreement as "salary makeup provisions" (Tr. 679-80), but that reference does not establish that the salary payments were to be guaranteed if Balin were no longer an employee. Rather, the import of that provision is that if Bass terminated Marshall or Balin as employees, their salaries would also terminate, but the resulting shortfall would be "made up" by redistributing the Denver Fees as they were originally intended to be distributed: 75% to Marshall and 25% to Balin. That is, the salary makeup provisions were intended to protect Marshall and Balin in the event that Robert Bass dismissed them both, in which case ARC-Management would then distribute the sum of both salaries, 75% to Marshall, and 25% to Balin. [23] Balin cannot now rewrite that agreement to cover a contingency that was not provided for -- Balin's termination by Marshall. Nor can this Court accord weight to Balin's position that Marshall confirmed, at a meeting in 1987, that the salary and benefits were, in fact, preferential distributions. Balin never recalled any such meeting until two years after his initial complaint was filed (Tr. 401), and there is no corroborative (i.e., non-self-serving) evidence that such a meeting ever occurred or that Marshall ever acknowledged that obligation. Moreover, Balin's own contemporaneous memorandum "to the file" reflects that after being told that his positions and salary at Amerimar Realty would be terminated, Balin noted only that this violated his understanding that he would be permitted to continue working three more months. Balin's memorandum does not show him taking the position that his salary was guaranteed irrespective of whether he was employed. DX 297.

2. Balin's Claim that Marshall Wrongfully Diverted the Denver Fees from Amerimar Realty.

[24] Finally, Balin asserts that because the Master Agreement is now the definitive governing document, the Denver fees must flow directly to Amerimar Realty. The fatal infirmity in this argument is that Balin never put the Master Agreement into effect. Instead, he disregarded that agreement and acquiesced in the quite different present fee flow structure by: (i) directing that the Denver fees continue to be distributed to ARMCO-Pa.; (ii) commencing litigation predicated upon ARMCO-Pa.'s entitlement to those fees; and (iii) accepting individual payments of fees, which necessarily were predicated upon ARMCO-Pa.'s entitlement to receive those fees. Having disregarded (and having never implemented) the Master Agreement, Balin cannot now be permitted to resurrect it and then attack the very fee structure in which he has acquiesced.[19]

The original Master Agreement, which Balin executed, was effective as of January 1, 1988, and purported to assign ARMCO-Pa.'s interest in the Denver Fees to Ameribass Realty. DX 343. One year later, on January 16, 1989, Balin was reminded of the fee-reallocation provision in the Master Agreement (PX 73), and, thus, was aware that the parties intended for the Denver Fees to flow directly from ARMCO-Co. to Ameribass Realty.

Despite his knowledge of the contracting parties' intent, Balin never effected the assignment. Instead, and contrary to the express terms of the Master Agreement, he permitted the Denver Fees to continue flowing to ARMCO-Pa.. Tr. 945-48. As long as Balin was at Amerimar Realty that arrangement never changed. Even thereafter, as late as October 26, 1992, the flow of the Denver Fees to ARMCO-Pa., and thus the continued failure to put the Master Agreement into effect, was an established fact and practice at Amerimar Realty. PX 189.

After his departure, Balin commenced two lawsuits, both premised upon the validity of the flow of the Denver Fees to ARMCO-Pa. In the Pennsylvania action, Balin claimed that Marshall improperly diverted

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[19]See Staples v. Billing, Del. Ch., C.A. No. 11339, Mem. Op. at 21, Jacobs V.C. (Jan. 31, 1994) ("one who has full knowledge of and accepts the benefits of a transaction may be denied equitable relief if he or she thereafter attacks the same transaction"); Papaiouana v. Commissioners of Rehoboth, Del. Ch., 186 A.2d 745, 749-50 (1962)("When a man with full knowledge, or at least with sufficient notice or means of knowledge of his rights, ... freely and advisedly abstains for a considerable lapse of time from impeaching [a transaction], there is acquiescence, and the transaction ... becomes unimpeachable in equity") (quoting Herman, Commentaries on the Law of Estoppel, at 1194).

money from ARC-Management to Amerimar Realty. DX 335. In his original complaint in this (Delaware) action, Balin alleges that distributions of the Denver Fees from ARMCO-Co. should flow first to ARMCO-Pa., and then, to ARC-Management. At the trial in this action, Balin's explanation for advancing this inconsistent claim was that when he filed his original complaint, he (mistakenly) believed that the Denver Fees should flow to ARMCO-Pa. and that the ARMCO-Pa. Partnership Agreement required the reallocation of those fees from Ameribass Realty to ARC-Management. Tr. 414-416.

It is undisputed that Balin, who knew that ARC-Management's sole source of income was the fees distributed by ARMCO-Pa., accepted payments from ARC-Management totalling $178,620 between June 1992 and September 1995. By claiming an entitlement to the funds distributed by ARC-Management, Balin necessarily validated the original arrangement calling for the distribution of the Denver Fees to ARMCO-Pa., then to ARC-Management, and finally, to Balin and Marshall. Balin's acceptance of this fee distribution arrangement for over a three year period is inconsistent with his present litigating position that those funds must, as a legal matter, flow directly to Amerimar Realty. See authorities cited at Note 19, supra.

[25] Balin responds that the doctrine of acquiescence should not bar his claim because Marshall had equal access to the Master Agreement and, therefore, was not prejudiced by Balin's inconsistent positions. The short answer is that prejudice is not an element of acquiescence and plays no part in the analysis. See Danvir Corp. v. Wahl, C.A. No. 8386, Berger V.C. (Sept. 8, 1987), at 11 (finding the plaintiff's claim barred due to acquiescence despite lack of detrimental reliance on plaintiff's conduct). The record establishes that Balin controlled the flow of fees and that Marshall and the other principals in the Amerimar organization relied on Balin's determination of where those fees should rightfully flow. Tr. 945-48, 1113.

Finally, Balin argues that, at the time he filed this action, he forgot the fee-reallocation provision of the Master Agreement because of the "size and complexity of the voluminous records in the case." Pl. Post-Trial Repl Brief, at 29. Factually, that explanation lacks credibility. Even if this excuse were acceptable as a legal matter, the record shows that: (i) Balin was aware of the Master Agreement assignment provision when the parties signed that Agreement; (ii) he was reminded of that provision one year later; (iii) his own conduct resulted in the Master Agreement never being put into effect; and (iv) Balin has advanced positions in the Pennsylvania action and in this litigation that are inconsistent with his present claim. In these circumstances, Balin cannot

now be heard to argue that he "forgot" about the Master Agreement's fee-reallocation provision and should, therefore, be allowed to "start all over again" by asserting claims that assume his past conduct never occurred.

VII. CONCLUSION

For all the reasons set forth:

1. Judgment shall be entered in favor of the defendants, and against the plaintiff, on all of the plaintiff's claims except for the claim that the defendants committed waste by wrongfully utilizing Amerimar Realty's tangible assets to conduct Amerimar Enterprises' business.
2. Judgment on that excepted claim shall await the determination of whether the plaintiff has standing to assert that claim. That issue shall be the subject to supplemental post-trial briefing; and
3. Judgment shall be entered for the plaintiff, and against the defendants, on the defendants' counterclaim.

Counsel shall confer and submit a form of order implementing the rulings made herein.

BARBIERI v. SWING-N-SLIDE CORP.

No. 14,239

Court of Chancery of the State of Delaware, New Castle

January 29, 1997

A director and officers of a corporation formed a limited liability company to act as one of two general partners in a general partnership, which was formed to make a tender offer for the corporation. Plaintiff, a stockholder in the corporation, brought an action challenging the terms and disclosure of the offer. Plaintiff subsequently filed a supplemental complaint against both the limited liability company and general

partnership suing for breach of fiduciary duty and equitable fraud. Defendants moved for dismissal on both claims.

The court of chancery, per Vice-Chancellor Steele, granted defendants' motion to dismiss equitable fraud claims against both the limited liability company and partnership. The court also dismissed breach of fiduciary duty claims against the partnership holding that, based on the facts presented by the plaintiff, it cannot be assumed that fiduciary duties owed to a corporation by one partner were imputed to the entire partnership. Such a claim requires sufficient factual support showing that the partnership knew of and/or benefited from the fiduciary relationship and that it aided and abetted the breach of fiduciary duty. With regards to breach of fiduciary duty claims against the limited liability company, however, the court denied defendants' motion to dismiss holding that fiduciary duties may be imputed to a separate business entity formed and controlled by fiduciaries for the purpose of engaging in a transaction with an entity to whom those duties are owed.

1. Corporations ⚷ 320(7)
   Pleading ⚷ 343
   Pretrial Procedure ⚷ 679

In a motion to dismiss, facts are drawn from the allegations of plaintiff's complaint and amended and supplemented complaint, and are accepted as true.

2. Corporations ⚷ 307

Directors and officers of a corporation owe fiduciary duties to the corporation and its shareholders.

3. Corporations ⚷ 307, 325

The existing fiduciary duties of a legal entity may be imputed to those in control of that entity.

4. Corporations ⚷ 379

In matters of member liability, limited liability companies are treated like corporations rather than partnerships. DEL. CODE ANN. tit. 6, § 18-303 (1996).

5. Corporations ⟹ 307, 316(.5)

As a general proposition, a shareholder will not automatically assume fiduciary duties merely by association with a single fiduciary.

6. Corporations ⟹ 307, 316, 325

Where a single director and management officers of a corporation form a limited liability company to make a tender offer for the corporation, the fiduciary duties of the director and officers must be imputed to the limited liability company they formed.

7. Corporations ⟹ 307, 316, 325

When allegations of a complaint support, directly or by inference, the conclusion that an entity formed and controlled by fiduciaries for purposes solely related to the entity to which those persons owed fiduciary duties, the entity may be considered to take on the same fiduciary obligations.

8. Corporations ⟹ 307
Partnership ⟹ 170

The nature of law firm partnerships is very different than that of business partnerships, in that, the privileged position accorded members of the bar requires that their relationships of trust be shared among their partners; therefore, a law firm may be charged with the fiduciary duties of its partners who served as a corporate director. Business partnerships, however, do not share this same responsibility.

9. Partnership ⟹ 170

It cannot be assumed that one of two business partners so controls or otherwise dominates the affairs of the partnership that the partnership must take on the fiduciary obligations of the single partner.

Michael Hanrahan, Esquire, and Elizabeth M. McGeever, Esquire, of Prickett, Jones, Elliott, Kristol & Schnee, Dover, Delaware; Terry Rose Saunders, Esquire, of Law Office of Terry Rose Sanders, Chicago, Illinois, of counsel; Joseph F. Devereux, Jr., Esquire, of Devereux, Murphy, Striler & Brickey, L.L.C., St. Louis, Missouri, of counsel; and

Kevin J. Richter, Esquire, of Mathis Marifian Richter & Grandy, Ltd., Belleville, Illinois, of counsel, for plaintiff.

Gregory P. Williams, Esquire, and Robert J. Stearn, Jr., Esquire, of Richards, Layton & Finger, Wilmington, Delaware; John S. Skilton, Esquire, of Foley & Lardner, Madison, Wisconsin, of counsel; Douglas M. Hagerman, Esquire, and Michael J. Aprahamian, Esquire, of Foley & Lardner, Milwaukee, Wisconsin, of counsel, for defendants GreenGrass Holdings and GreenGrass Management, LLC.

STEELE, *Vice-Chancellor*

I. Issue Presented

A director and several officers of a corporation form a limited liability company to act as one of two general partners in a general partnership that then makes a tender offer for the corporation. The issue here presented is whether a cognizable claim for breach of fiduciary duty may be stated against the limited liability company and/or the general partnership by shareholders of the corporation. I conclude that fiduciary duties may be imputed to a separate entity formed and controlled by fiduciaries for the purpose of engaging in a transaction with an entity to whom those duties are owed. I further conclude it cannot be assumed, in the context of a business partnership, that one partner so controls the other that its fiduciary obligations may be imputed to the partnership.

II. Background[1]

[1] Plaintiff brought this action in April 1995 to challenge the terms and disclosure of a self-tender by Swing-N-Slide ("SNS"), a Delaware corporation in which he holds shares. Following the self-tender,[2] plaintiff amended and supplemented his complaint (the "supplemental complaint"), challenging the terms of a two-step tender offer by newly added defendants Greengrass Holdings, a Delaware general partnership ("Holdings"), and Greengrass Management, LLC ("Management"). On

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[1]Because this is a motion to dismiss, the facts are drawn from the allegations of plaintiff's complaint and amended and supplemented complaint, and are accepted as true for present purposes. *See Grobow v. Perot*, Del. Supr., 539 A.2d 180 (1988).

[2]A more thorough recitation of the background facts and description of the self-tender transaction may be found in *Barbieri v. Swing-N-Slide Corp.*, Del. Ch., C.A. No. 14239, Steele, V.C. (May 7, 1996).

7 May 1996 I certified the class action claims of the complaints.[3] Thereafter, Holdings and Management moved for dismissal of the breach of fiduciary duty and equitable fraud claims asserted against them in the supplement complaint.[4]

Plaintiff's claims for breach of fiduciary duty against Holdings and Management are based upon a transaction agreement between SNS and Holdings. The terms of the agreement provide for Holdings to offer to purchase up to sixty percent of SNS common stock at $6.50 per share in cash. Completion of the tender offer portion will thus give Holdings a majority stake in SNS, and entitle it to nominate a majority of the SNS directors. The second step of the transaction is a commitment by Holdings to purchase several million dollars of its choice of either preferred shares or debentures, both convertible into SNS common on a $4.80 per share basis in the event of a change of control at SNS. Holdings also agreed to use its best efforts to file a registration statement covering the same security as it chose to purchase in order to allow SNS shareholders to purchase a *pro rata* portion on the same terms. The transaction agreement also contained a "no-shop" and several fee payment provisions.

Most important, for present purposes, is the composition of the several entities involved in the transaction. Holdings, the offeror/ acquiror, is a Delaware general partnership. There are two partners in the partnership, Management and Greengrass Capital ("Capital"). Capital is a Delaware LLC, owned and controlled by parties unrelated and unaffiliated with SNS. Management, however, was "organized by defendant [Richard G.] Mueller and other members of Swing-N-Slide's senior management[.]"[5] At the time of the transaction agreement, Mueller was a SNS director, as well as its president and chief executive. The duties inherent in his position and that of the other senior officers of SNS on both sides of the transaction agreement form the basis of the claims against Holdings and Management.

IV. Discussion

The underlying theory advanced in support of plaintiff's claims against Holdings and Management is succinctly stated as follows:

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[3]*See id.*

[4]Plaintiff agrees the facts pleaded in its supplemental and amended complaint are insufficient to support its equitable fraud claims against Holdings and Management. *See* Pl.'s Ans. Brief at 13. Accordingly, those claims are dismissed without discussion.

[5]Amend. and Supp. Compl. ¶ 53.

"Because defendant Mueller, a Swing-N-Slide director and president and chief executive officer, and other Swing-N-Slide officers are the owners of Greengrass management, which in turn is one of the two general partners of Greengrass [Holdings], Greengrass Management and Greengrass [Holdings] owe fiduciary duties to the Swing-N-Slide stockholders."[6] The briefs submitted on this motion argue only in favor of or against this theory, and do not address allegations concerning breach of duty. Accordingly, I address only the narrow issue argued: whether Holdings and/or Management owe fiduciary obligations to SNS and its shareholders.

[2] In testing plaintiff's theory, I start with the basic proposition that directors and officers of a corporation owe fiduciary duties to the corporation and its shareholders. In this instance, it is alleged that Mueller, a director and officer and the senior management officers of SNS (unnamed and of unknown number), organized Management. Those persons forming Management therefore owed fiduciary duties to SNS. Unfortunately, none of the cases cited by either party answer the necessary next question:

Must their fiduciary obligations be imputed to the entity they formed?

Defendants rely on a series of cases holding that a non-fiduciary takes on fiduciary duties only when it becomes a majority shareholder or otherwise exercises control over the entity at issue.[7] Defendants argue that since Holdings and Management, as independent legal entities, did not own or control SNS at the time of the tender offer, neither Holdings nor Management can have fiduciary obligations to SNS or its shareholders. But this argument answers only the question of when an otherwise unaffiliated entity becomes a fiduciary. Plaintiff argues Management had existing fiduciary obligations to SNS from the instant Mueller, *et al.*, formed it. Defendants' argument thus fails to address the very different question of whether a legal entity must take on the preexisting fiduciary duties of those who form and control it.

[3-5] Plaintiff offers two cases in support of its position that Management owed fiduciary obligations to SNS and its shareholders from the outset. The first is not helpful. It stands for the inverse proposition that the existing fiduciary duties of a legal entity may be imputed to those in control of that entity.[8] The second, ***In re Ft. Howard Corp.***

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[6]Amend. and Supp. Cmpl. ¶ 99.

[7]*See* Defs.' Reply Brief at 2-5 (citing cases).

[8]*In re USACafes, L.P. Litig.*, Del. Ch., 600 A.2d 43, 47-50 (1991).

Shareholders Litig.,[9] provides some support for plaintiff's position, but also fails to answer the immediate issue. In ***Ft. Howard***, Chancellor Allen "assum[ed] for present purposes [a decision on motion for preliminary injunction] that having entered upon a co-venture with the management directors relating to the Company, that [the investment bank] must operate under the same rules that apply to [the] fiduciaries."[10] Leaving aside the point that the Chancellor's single statement was an assumption for the limited purpose of deciding an expedited motion, the significant distinction remains that ***Ft. Howard*** concerned a co-venture of undetermined structure, whereas in the present case the officers have formed a distinct legal entity.[11] Surprisingly, I do not find any case within this jurisdiction addressing this issue.[12]

[6-7] I conclude, however, that on the facts presented, the fiduciary duties of the SNS director and officers must be imputed to the limited liability company they formed. Accepting plaintiff's allegations as true, and drawing favorable logical inferences, the complaints support the following: A single director and the management officers of SNS together formed a limited liability company. It is not suggested that there are other persons or entities involved in the LLC. Nor is it suggested that Management was formed for or has carried out any other objective than one related to the SNS tender offer. I therefore fairly conclude that persons in positions owing fiduciary responsibility to SNS and its shareholders together formed a separate entity for purposes solely related to that company. Neither Mueller nor the others would escape their fiduciary obligations to SNS had they not formed Management. To allow them to use this State's laws allowing the formation of the limited liability company as a vehicle to avoid those very duties would be unconscionable. Therefore, where, as here, the allegations of the complaint support, directly or by inference, the conclusion that an entity was formed and controlled by fiduciaries for purposes solely related to

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[9]Del. Ch., C.A. 9991, Allen, C. (Aug. 8, 1988), Mem. Op.

[10]*Id.* at 39.

[11]In matters of member liability, limited liability companies are treated like corporations rather than partnerships. *See generally 6 Del. C.* § 18-303 ("Liability to 3rd parties."); ***Poore v. Fox Hollow Enters.***, Del. Super., C.A. No. 93A-09-005, Steele, J. (Mar. 29, 1994), Let. Op. at 2-3.

[12]At oral argument, defendants additionally offered ***In re Int'l Jensen, Inc. Shareholders Litig.***, Del. Ch., C.A. No. 14992, Jacobs, V.C. (Aug. 20, 1996), Mem. Op. at 39 n.18. I have no quarrel with the opinion expressed in the ***Jensen*** footnote. As a general proposition, a shareholder will not automatically assume fiduciary duties merely by association with a single fiduciary. But the allegations in this case, to which the holding is limited, present markedly different circumstances.

the entity to which those persons owed fiduciary duties, the entity may be considered to take on the same fiduciary obligations.

[8-9] There remains the second part of plaintiff's theory, however, concerning Holding's liability. As noted above, the complaints allege that Holdings is a general partnership comprised of two partners: Management and Capital. Since there is no contention that Capital had preexisting fiduciary duties to SNS and its shareholders, the question posed is whether the partnership must take on the imputed fiduciary duties of one of its partners. Plaintiff has cited two cases in which a law firm was charged with the fiduciary duties of its partners who served as a corporate director.[13] Both of the cases, however, were decided in the context of discovery disputes and assertion of the attorney-client privilege. I will not now extend the theory of those cases more broadly. The nature of law firm partnerships is very different than that of business partnerships. The privileged position accorded members of the bar requires that their relationships of trust be shared among their partners. Business partnerships do not share this same responsibility. I will not assume, at least on the facts thus far alleged, that one of two partners so controls or otherwise so dominates the affairs of the partnership that the partnership itself must take on the fiduciary obligations of a single partner.

The complaints suggest Management and Capital formed Holdings for the purpose of the SNS tender offer, and Management breached its fiduciary duties to SNS in that offer. Nonetheless, plaintiff has not articulated facts supporting a claim that Holdings knew of and/or benefitted from the Management/SNS relationship and that Holdings aided and abetted a Management breach of imputed fiduciary duty.

IV. Conclusion

Defendants' motion to dismiss plaintiff's claim against Holdings and Management for equitable fraud is ***granted.*** With respect to plaintiff's breach of fiduciary duty claims, the allegations of plaintiff's complaint and amended and supplemental complaint are sufficient to conclude that, as to Management, the motion to dismiss must be ***denied.*** As to Holdings, plaintiff's claim for breach of fiduciary duty must be dismissed. Defendants' motion to dismiss against Holdings will be ***granted*** without prejudice subject to 60 days leave to file a further amended complaint stating a claim for aiding and abetting Management's

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[13]*See* Pl.'s Ans. Brief at 7 (citing *Deutsch v. Cogan*, Del. Ch., 580 A.2d 100, 107 (1990) and *Valente v. Pepsico, Inc.*, 68 F.R.D. 361, 369 (D. Del. 1975)).

alleged breach of fiduciary duty. Management's motion to dismiss is ***granted in part and denied in part.*** Holdings motion to dismiss the claim for equitable fraud is granted with prejudice. Holdings' motion to dismiss the claim for breach of fiduciary duty is dismissed without prejudice.

IT IS SO ORDERED.

BODKIN v. MERCANTILE STORES CO.

No. 13,770

Court of Chancery of the State of Delaware, New Castle

November 1, 1996

Defendants filed a motion to dismiss for failure to comply with the demand and pleading requirements of Chancery Court Rule 23.1. Plaintiffs claimed they satisfied the requirements by alleging that demand was excused because the directors sought to entrench themselves in office and terminated negotiations for the sale of the company, because the potential acquiror refused to accept "lavish" severance packages for top corporate executives or a particular tax treatment demanded by three of the company's eleven directors. Plaintiffs further alleged that demand should be excused, because the board was dominated and controlled by three directors and a majority of the directors had disabling conflicts of interest preventing them from exercising independent business judgment.

The court of chancery, per Vice-Chancellor Chandler, granted the motion to dismiss pursuant to Rule 23.1, because plaintiffs failed to demonstrate with particularized allegations that the negotiations posed an actual threat to the directors' positions and failed to demonstrate that the proposed tax structure afforded different treatment to the directors than that afforded to the shareholders.

1. Corporations ⟹ 206(4), 211(3)

Pursuant to Rule 23.1, which sets forth the pleading requirements for a derivative suit, a complaint shall allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort. DEL. CH. CT. R. 23.1.

2. Corporations ⟹ 206(4), 211(5)

To determine whether a plaintiff, in the absence of making a demand upon a board, has satisfied the demand requirements of Rule 23.1, a court must decide whether, under the particularized facts alleged, a reasonable doubt is created that (1) the directors are disinterested and independent and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment. DEL. CH. CT. R. 23.1.

3. Corporations ⟹ 206(4), 211(5)

The first of two independent ways in which a plaintiff may successfully meet the demand requirements is by pleading particularized facts either (1) alleging that a majority of the directors were interested in the transaction as indicated by the existence of financial interests or entrenchment motives, or (2) alleging that directors, constituting a majority of the board, were dominated or controlled by a party with an interest in the transaction and thus unable to independently exercise business judgment.

4. Corporations ⟹ 206(4), 211(5), 310(1)

The second of two independent ways in which a plaintiff may successfully meet the demand requirements is by pleading particularized facts alleging that the directors, though disinterested and independent, failed to exercise proper business judgment.

5. Corporations ⟹ 206(4), 314(.5), 320(5)

The fact that certain director/shareholders may have disfavored a proposed offer because of financial concerns about personal tax liabilities does not rebut the presumption that they acted in a disinterested fashion

absent particularized allegations that the transaction did not apply to them on terms equal with all other shareholders.

6. Corporations ⚷ 206(4), 211(5), 310(1)

Failing to raise a reasonable doubt that the directors were financially disinterested, plaintiffs may satisfy the demand requirements by casting doubt on the presumption that the directors' decisions were valid exercises of business judgment and not motivated by entrenchment purposes.

7. Corporations ⚷ 206(4), 211(5), 310(1), 320(5)

A claim casting doubt on the presumption that the directors' decisions were valid exercises of business judgment and not motivated by entrenchment purposes requires an allegation that the challenged transaction posed an actual threat to the directors' positions on the board.

8. Corporations 206(4), 211(5), 310(1)

Plaintiffs fail to raise a reasonable doubt that directors are disinterested in the transaction and not influenced by entrenchment motives where plaintiffs fail to allege that the offer of sale of the company posed an actual threat to the directors' continued employment and where supporting particularized facts required by Rule 23.1 were not plead.

9. Corporations ⚷ 206(4), 211(5)

Notwithstanding plaintiffs' allegations that four of eight directors had positions as directors or officers on companies privately held by three other directors might be sufficiently particularized to meet the pleading standards of Rule 23.1, plaintiffs' allegations failed to raise a reasonable doubt that the board as a whole was disinterested when plaintiffs had not demonstrated a reasonable doubt that the dominating or controlling directors were disinterested. DEL. CH. CT. R. 23.1.

10. Corporations ⚷ 211(5)
Pretrial Procedure ⚷ 681

Defendants' motion to dismiss will be granted when plaintiffs have failed to make a demand on the board of directors or have failed to

demonstrate with particularized allegations why demand is excused according to Rule 23.1. DEL. CH. CT. R. 23.1.

Pamela S. Tikellis, Esquire, of Chimicles, Jacobsen & Tikellis, Wilmington, Delaware; and Gary S. Jacobson, Esquire, of Lovell & Skirnick, LLP, New York, New York, of counsel, for plaintiffs.

Stuart B. Young, Esquire, and Bruce L. Silverstein, Esquire, of Young, Conaway,.Stargatt & Taylor, Wilmington, Delaware; and Eliot Lauer, Esquire, and Joseph P. Goldberg, Esquire, of Curtis, Mallet-Prevost, Colt & Mosle, New York, New York, of counsel, for defendant Mercantile Stores Company, Inc.

Andrew B. Kirkpatrick, Jr., Esquire, William O. LaMotte, III, Esquire, and Karen Jacobs Louden, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for defendants Minot K. Milliken, Roger Milliken, Gerrish Milliken, H. Keith Brodie, Rene C. McPherson, Roger K. Smith, John A. Herdeg, Thomas J. Malone, Francis G. Rodgers, George S. Moore, and David L. Nichols.

CHANDLER, *Vice-Chancellor*

Shareholders allege that corporation's directors sought to entrench themselves in office and terminated negotiations for the sale of the company because the potential acquiror refused to accept "lavish" severance packages for top corporate executives or a particular tax treatment demanded by three of the company's eleven directors. Because I find that the shareholders in this derivative suit fail to allege that the negotiations posed an actual threat to the directors' positions and fail to demonstrate that the proposed tax structure afforded a different treatment to the directors than that afforded to shareholders, defendants' motion to dismiss for failure to make demand upon the board is granted.

I. BACKGROUND

Plaintiffs, Francis and Irene Bodkin, own 500 shares of Mercantile Stores Company, Inc. ("Mercantile") common stock purchased at $55 3/8 on September 9, 1994, in reliance upon reports that Mercantile was involved in negotiations for the sale of the company. One week later, Mercantile announced that it had ended negotiations. Press reports identified May Department Stores Company ("May Stores") as the potential acquiror. Upon these announcements, the share price of

Mercantile common stock dropped $16 13/32 to $38 23/32. Defendants are Mercantile and its entire eleven-member Board of Directors. Three directors, brothers Roger and Gerrish Milliken and their cousin Milot Milliken (collectively, the "Millikens"), are Mercantile's largest shareholders with a combined ownership of just over forty percent of Mercantile's outstanding common stock.

Plaintiffs allege that by rejecting the May Stores' offer and terminating negotiations, Mercantile's Board breached its fiduciary duties to Mercantile's shareholders. Specifically, plaintiffs allege that defendants sought to entrench themselves in their positions and terminated negotiations because May Stores would not accept "lavish" severance packages for senior Mercantile executives or a particular tax treatment insisted upon by the Millikens. In addition, plaintiffs argue that demand should be excused because the Board is dominated and controlled by the Millikens and a majority of the directors have disabling conflicts of interest preventing them from exercising independent business judgment. Defendants filed a motion to dismiss for failure to comply with the demand and pleading requirements of Chancery Court Rule 23.1 and for failure to state a claim as required by Rule 12(b)(6).

II. MOTION TO DISMISS FOR FAILURE TO SATISFY DEMAND AND PLEADING REQUIREMENTS OF RULE 23.1

Defendants allege that plaintiffs have failed to comply with the demand and pleading requirements of Chancery Court Rule 23.1. Consequently, they ask this Court to dismiss the complaint until plaintiffs have first made a pre-suit demand upon the Mercantile Board of Directors. Plaintiffs claim to satisfy Rule 23.1 requirements by demonstrating that demand is excused because directors, constituting a majority of the Board, have financial interests or entrenchment motives which prevent them from exercising independent business judgment. Because I find that plaintiffs have failed to demonstrate that the Millikens have a financial interest adverse to that of other shareholders or demonstrate (or even allege) that the May offer posed an actual threat of removal from office to a majority of the directors, defendants' motion to dismiss for failure to make demand is granted.

[1] Chancery Court Rule 23.1 sets forth the pleading requirements for a derivative suit. Under this rule, a complaint shall:

> "allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the

> plaintiff's failure to obtain the action or for not making the effort."

It is admitted that plaintiffs have failed to make a demand upon the Board. What is questioned is whether plaintiffs have pled "with particularity" sufficient reasons for failing to make such demand.

A. The Aronson Test

[2-4] To determine whether a plaintiff, in the absence of making a demand upon a board, has satisfied the demand requirements of Rule 23.1, this Court "must decide whether, under the particularized facts alleged, a reasonable doubt is created that: (1) the directors are disinterested and independent and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment."[1] Despite its conjunctive connection, the test provides two independent ways in which a plaintiff may successfully meet the demand requirements.[2] First, plaintiffs may plead particularized facts alleging that a majority of the directors were interested in the transaction, as indicated by the existence of financial interests or entrenchment motives.[3] In the alternative, plaintiffs may plead particularized facts alleging that directors, constituting a majority of the board, were dominated or controlled by a party with an interest in the transaction and thus unable to independently exercise business judgment.[4] Second, plaintiffs may plead particularized facts alleging that the directors, although disinterested and independent, failed to exercise proper business judgment.[5]

B. Plaintiffs' Complaint

Plaintiffs claim they have satisfied the first prong of *Aronson* by pleading particularized facts supporting the allegation "that a majority of Mercantile's eleven-member board have [sic] disqualifying financial or entrenchment interests such that the directors could not have made the decision to terminate merger negotiations impartially, nor can they now be expected impartially to prosecute an action against defendants."[6]

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[1]*Aronson v. Lewis*, Del. Supr., 473 A.2d 805, 814 (1984).
[2]*Levine v. Smith*, Del. Supr., 591 A.2d 194, 206 (1991).
[3]*Grobow v. Perot*, Del. Supr., 539 A.2d 180, 188 (1988).
[4]*Id.* at 189.
[5]*Id.*
[6]Plaintiffs' Memorandum of Law in Opposition to Defendants' Motion to Dismiss at 21.

Furthermore, plaintiffs' complaint states that the Board "is dominated and controlled by the Millikens and is thereby disabled from independently considering whether to bring an action arising from the breaches of fiduciary duty alleged herein."[7] Thus, plaintiffs' complaint may be read to allege claims based on both a lack of disinterest and a lack of independence.

1. Interest:

According to the complaint, negotiations with May Stores were terminated, in part, because "the deal could not be structured to assuage the Millikens' concern about their personal tax liabilities."[8] Plaintiffs assert that such tax concerns are a financial interest which raises a reasonable doubt that the Millikens are disinterested in the transaction. Defendants, relying on *Aronson*, argue that to be disqualifying, a financial interest must provide "a personal financial benefit . . . not equally shared by the stockholders"[9] and that plaintiffs have failed to satisfy Rule 23.1 because they have not alleged particularized facts demonstrating how the May Stores' offer would accord the Millikens a tax treatment any different than that which would be accorded to other shareholders. At oral argument, plaintiffs acknowledged that the complaint lacks particularized facts, but asserted that a reasonable inference may be made, based on the size of the Millikens' stock holdings and the length of time the Millikens have held these shares, that the Millikens have a relatively lower tax basis and a relatively larger tax liability than other shareholders. Thus, plaintiffs claim that although the tax structure of the transaction would apply to all shareholders equally, the unique effect of this structure upon the Milliken directors would be sufficient to raise a reasonable doubt as to their ability to exercise independent business judgment.

[5] Even if plaintiffs' assertions that a reasonable inference may be made as to the existence of the Millikens' unique tax liabilities were sufficient to meet the particularized pleading requirements of Rule 23.1, such unique personal tax liabilities alone do not create a reasonable doubt that the Millikens are disinterested. In support of their argument for a more subjective standard, plaintiffs rely on *Rales v. Blasband*:

> Directorial interest also exists where a corporate decision will have a materially detrimental impact on a director, but

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[7]2d. Am. Compl. at ¶ 20(a).
[8]*Id.* at ¶ 12.
[9]*Aronson* at 812.

> not on the corporation and the stockholders. In such circumstances, a director cannot be expected to exercise his or her independent business judgment without being influenced by the adverse personal consequences resulting from the decision.[10]

But, plaintiffs misinterpret the Supreme Court's statement in *Rales*. The "materially detrimental impact" refers to the application of the tax treatment upon the directors, not the resulting personal effect upon the directors generated by the uniform application of the tax laws. Thus, without facts demonstrating that the Millikens received one type of tax treatment and the other shareholders a different type, the fact that the Millikens may have disfavored the proposed offer because of personal financial concerns does not rebut the presumption that they acted in a disinterested fashion. The Millikens' personal tax liabilities may lead them to oppose the structure of the offer. But those interests, which arise because they are shareholders, do not establish a disabling conflict for them as directors, absent particularized allegations that the transaction did not apply to them on terms equal with all other shareholders.[11]

[6-8] Failing to raise a reasonable doubt that the directors were financially disinterested, plaintiffs may satisfy the first prong of *Aronson* by casting doubt on the presumption that the directors' decisions were valid exercises of business judgment and not motivated by entrenchment purposes.[12] Such a claim, however, requires an allegation that the challenged transaction posed an actual threat to the directors' positions on the Board.[13] Here no such allegation exists. Plaintiffs merely state that directors "have breached and are continuing to breach their fiduciary duties to Mercantile's shareholders in order to entrench themselves in office and to continue receiving their compensation, fees, and emoluments of office."[14] If this were the directors' "sole or primary purpose" behind the termination of negotiations, it would be a breach of fiduciary duty.[15] But without an allegation that the offer posed an actual threat to their continued employment as directors, and without the supporting particularized facts required by Rule 23.1, I cannot find that plaintiffs

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[10]*Rales v. Blasband*, Del. Supr., 634 A.2d 927, 936 (1993).

[11]*In re Anderson, Clayton Shareholders Litig.*, Del. Ch., 519 A.2d 680 (1986).

[12]*Moran v. Household Int'l., Inc.*, Del. Ch., 490 A.2d 1059, 1071, *aff'd*, Del. Supr., 500 A.2d 1346 (1985); *Pogostin v. Rice*, Del. Supr., 480 A.2d 619, 627 (1984).

[13]*Grobow v. Perot*, Del. Ch., 526 A2d. 914, 922-23 (1987), *aff'd*, Del. Supr., 539 A2d. 180 (1988).

[14]2d. Am. Compl. at ¶ 17.

[15]*Pogostin* at 627.

have raised a reasonable doubt that the directors are disinterested in the transaction and not influenced by entrenchment motives.

2. Independence:

[9] Plaintiffs also seek to satisfy the first prong of *Aronson* by alleging particularized facts in support of their claim that the board "is dominated and controlled by the Millikens."[16] These facts include allegations that three of the eight directors who are not related to the Milliken family hold positions as directors on the board of the privately-held Milliken & Company, and one of the other eight directors is the president, chief operating officer and director of Milliken & Company as well as a director of Lockhart Power Co., a subsidiary of Milliken & Company. While these and other facts may be sufficiently particularized to meet the pleading standards of Rule 23.1, plaintiffs have not demonstrated a reasonable doubt that the Millikens are disinterested. Without this link to an interested party, plaintiffs' allegations fail to raise a reasonable doubt that the Board as a whole is disinterested.[17]

[10] Because plaintiffs have failed to make a demand on the Mercantile Board of Directors, or to demonstrate with particularized allegations why demand is excused, I grant defendants' motion to dismiss.[18] Having dismissed the complaint on this basis, I need not reach the issues raised by defendants' Rule 12(b)(6) motion.[19]

IT IS SO ORDERED.

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[16]2d. Am. Compl. at ¶ 20(a).

[17]*Grobow* at 189; *Friedman v. Beningson*, Del. Ch., C.A. No. 12232, Allen, C. (Dec. 4, 1995).

[18]Ch. Ct. Rule 23.1.

[19]*Colonial Sec. Corp. v. Allen*, Del. Ch., C.A. No. 6778, Longobardi, V.C. (April 18, 1983).

CARLTON INVESTMENTS v. TLC BEATRICE INTERNATIONAL HOLDINGS, INC.

No. 13,950

Court of Chancery of the State of Delaware, New Castle

January 28, 1997

Movant was a Special Litigation Committee (SLC) of the board of directors of defendant TLC Beatrice International Holdings, Inc. A proposed settlement had been negotiated between the SLC and the defendants after several years of litigation by the shareholder plaintiff. In anticipation of a challenge to the proposed settlement, plaintiff sought discovery. The SLC moved for a protective order limiting discovery.

The court of chancery, per Chancellor Allen, determined that discovery should be limited to inquiries into the independence and good faith of the SLC, and the bases supporting its conclusion. The court granted the SLC's motion for a protective order on all documents beyond those which the SLC had previously agreed to permit, except that plaintiff would also be permitted discovery on communications between the SLC and the defendants regarding the claims or the settlement. The SLC's motion for a protective order barring deposition of their lead counsel was likewise granted.

1. Pretrial Procedure ⟹ 25, 27

Where a proposed settlement has been entered into by a special litigation committee and the parties are preparing to present a settlement to the court for its approval, the usual liberal discovery rules do not apply. Instead, a more limited and targeted discovery is appropriate.

2. Compromise and Settlement ⟹ 56
   Pretrial Procedure ⟹ 25, 27

Where a proposed settlement has been entered into by a special litigation committee and the parties are preparing to present a settlement to the court for its approval, discovery requests should be tailored to facilitate the determination of the critical issues at this stage in the proceeding, which are the independence and good faith of the committee and the bases supporting its conclusions.

3. Compromise and Settlement ⚷ 56

Where a proposed settlement has been entered into by a special litigation committee (SLC), an evaluation of whether the SLC knew enough about the strengths and weaknesses of the claims to negotiate a fair and reasonable settlement, and whether the settlement reached is fair and reasonable, is required.

4. Compromise and Settlement ⚷ 56
Pretrial Procedure ⚷ 25, 27

Once a special litigation committee (SLC) has entered into a proposed settlement with defendants, discovery into the merits of the derivative plaintiff claims are generally or presumptively beyond the scope of this inquiry, because the utilization of a SLC would be defeated without any showing of evidence that the committee did not proceed in good faith.

5. Pretrial Procedure ⚷ 25, 27

A derivative plaintiff is not entitled to the production of thousands of documents reviewed by a special litigation committee, because discovery at this stage in the proceedings is in the discretion of the court and must fit the occasion.

6. Compromise and Settlement ⚷ 4.5
Corporations ⚷ 202

Counsel representing a fiduciary in court has a very particular burden of candor to the court, in that the excesses to which the zealous advocacy model of lawyer identity can lead, have no place in such representation.

7. Pretrial Procedure ⚷ 27, 29

When a special litigation committee provides plaintiff with a brief in support of the proposed settlement, rather than a report, its brief is regarded to have the same integrity as would any report insofar as it contains statements of fact; therefore, plaintiff is not entitled to further discovery.

8. Pretrial Procedure ⟹ 25, 27, 29

Where there has been two years of discovery and plaintiff has already had an opportunity to do discovery on the merits, plaintiff will be limited in its discovery because plaintiff is expected to be well-equipped, without further discovery, to evaluate the independence, good faith, and the reasonableness of the special litigation committee's investigation and conclusions, especially where a detailed description of the special litigation committee investigation is provided in its brief.

9. Pretrial Procedure ⟹ 25, 27

After a special litigation committee (SLC) has entered into a proposed settlement, and plaintiff had nearly two years opportunity for discovery and has been presented with a report in the form of a detailed brief, plaintiff is only entitled to the production of documents narrowly related to the independence and good faith of the SLC which a prior opportunity to seek in discovery requests has not been afforded.

10. Pretrial Procedure ⟹ 25, 27, 30

After a special litigation committee (SLC) has entered into a proposed settlement and plaintiff, who has had two years of discovery, is provided with a detailed report, the SLC must produce those documents which relate to the creation of the SLC and appointment of its members, retention letters, and communications which may be relevant to good faith claims.

11. Compromise and Settlement ⟹ 4.5
Corporations ⟹ 202
Pretrial Procedure ⟹ 91, 100

Generally, in Delaware, counsel to special litigation committees are not deposed regarding the assistance or advice they provide their clients in actions involving derivative plaintiffs; however, where a member of the committee died prior to being deposed, counsel will be permitted to be deposed.

12. Compromise and Settlement ⟹ 4.5, 56, 57
Pretrial Procedure ⟹ 91, 100

Important information at a stage of the proceeding, which consists of what the special litigation committee (SLC) knew and did during the investigation and in reaching its conclusions, may be obtained by deposing the SLC members themselves and not by deposing SLC's counsel; however, a different result may occur if there are grounds that counsel acted in bad faith by manipulating the process in violation of duty in an attempt to affect SLC deliberations.

Thomas J. Allingham, II, Esquire, Cathy L. Reese, Esquire, and Kevin M. Maloy, Esquire, of Skadden, Arps, Slate, Meagher & Flom, Wilmington, Delaware, for plaintiff.

Kenneth J. Nachbar, Esquire, Alan J. Stone, Esquire, and Davis J. Teklits, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware; and Richard C. Tufaro, Esquire, Fred W. Reinke, Esquire, and Melissa R. Hodgman, Esquire, of Milbank, Tweed, Hadley & McCloy, Washington, D.C., of counsel, for Special Litigation Committee.

ALLEN, *Chancellor*

Pending is a motion by the Special Litigation Committee ("SLC") of the Board of Directors of TLC Beatrice International Holdings, Inc., ("TLC Beatrice") for a protective order with respect to discovery requests of plaintiff, Carlton Investments ("Carlton") in connection with a proposed settlement of this derivative litigation. The proposed settlement was negotiated between the SLC and the defendants[1] after several years of litigation by the shareholder plaintiff. It was reached after a five-month investigation by the SLC, which is comprised of newly appointed directors. A hearing on the fairness of the proposed settlement has been set down. In anticipation that Carlton will oppose the proposed settlement when it is presented to this Court for its approval, pursuant to Chancery Court Rule 23.1, Carlton served the SLC with the disputed discovery request.

[1]The defendants in this action include Loida N. Lewis and Leslie Lewis, co-executrixes of the estate of Reginald F. Lewis, TLC Group, L.P, TLC General Corp., McCall Pattern Holdings, Inc., twelve present and former directors of TLC Beatrice, the former general counsel of TLC Beatrice, and TLC Beatrice itself, as the nominal defendant in the derivative action.

[1-3] At this juncture, where a proposed settlement has been entered into by a special litigation committee and the parties are preparing to present a settlement to the Court for its approval, the usual liberal discovery rules do not apply. Instead, for the reasons set forth in *In re Amstead Indus., Inc., Litig.*, "a more limited and targeted discovery" is appropriate. Del. Ch., 521 A.2d 1104, 1107 (1986). Discovery requests should be tailored to facilitate the determination of the critical issue at this stage in the proceeding. Those principal issues are "the independence and good faith of the committee and the bases supporting its conclusions." *See Zapata Corp. v. Maldonado*, Del. Supr., 430 A.2d 779, 788 (1981). In other words, is the SLC independent on this issue? Did it act in a good faith effort to benefit the corporation and was the committee sufficiently informed of the relevant facts to make a judgment that deserves the type of deference ordinarily captured by the "business judgment rule?" Thus, this inquiry requires an evaluation of whether the SLC knew enough about the strengths and weaknesses of the claims to negotiate a fair and reasonable settlement, and whether the settlement reached is in fact fair and reasonable. *See In re Amstead Indus., Inc., Litig.*, 521 A.2d at 1107.

* * *

On January 6, 1997, Carlton served the SLC with an extensive document request. Carlton has asked the SLC to *identify* all documents received by it or its advisors in connection with their investigation and the proposed settlement, and to *produce* all of such documents that Carlton does not already possess. In addition, Carlton seeks to depose the two members of the SLC, the SLC's lead legal counsel, and the executive compensation expert hired to assist the SLC in its investigation. Carlton asserts that this discovery request is narrowly targeted and necessary for it to adequately investigate the good faith and independence of the SLC and its advisors and the basis for and reasonableness of the claims brought by Carlton in the derivative action. According to Carlton, it is not requesting documents generated by the SLC or its counsel relating solely to Carlton's opposition to the proposed settlement.

The SLC contends that Carlton is entitled to a much more limited type of discovery at this time, characterizing Carlton's document request as overbroad, improper, and inappropriate in that it asks for privileged materials. According to the SLC, Carlton's request seeks documents irrelevant to the issue of the SLC's good faith and independence. The SLC has agreed to produce documents relating to the creation of the SLC and appointment of its two members, as well as retention letters between the SLC and its counsel and its counsel and the compensation expert, Ms.

Eichen. In addition, the SLC has agreed to three of the four requested depositions, asking this Court to disallow only the deposition of its lead counsel, Mr. Tufaro.

After reviewing Delaware case law pertaining to this discovery issue, I have concluded that the SLC is entitled to the requested protective order, limiting Carlton's discovery to the narrow issue of the independence and good faith of the SLC, as defined below, and the depositions of only the SLC members and compensation expert. What is at issue is what the SLC members understood and what the basis is for their judgment. Seeing the matter in this way, it is unnecessary to rule upon the issues of attorney client and work product privileges.

A brief review of the creation, appointment, investigation, and proposed settlement of the SLC, is necessary to understand the factual underpinnings of this legal determination.

I. BACKGROUND

Carlton filed the pending Delaware derivative action on behalf of TLC Beatrice on January 4, 1995. The original complaint asserted numerous claims against former CEO, Reginald Lewis, and several other officers and directors of TLC Beatrice who allegedly breached their fiduciary duties to the Company, committed corporate waste, and participated in acts of fraud and conspiracy. *See Carlton Investments v. TLC Beatrice Int'l Holdings, Inc.*, Del. Ch., C.A. No. 13950, Allen, C. (Nov. 21, 1995). A first and second amended complaint were filed thereafter, adding claims of usurpation of corporate opportunity, fraud and conspiracy in connection with TLC Beatrice's French subsidiaries, and voting rights that the management had assigned to Reginald Lewis. *See Carlton Investments v. TLC Beatrice Int'l Holdings, Inc.*, Del. Ch., C.A. No. 13950, Allen, C., Mem. Op. (April 16, 1996).

Over the past two years, extensive discovery has occurred since the filing of the derivative action, involving the production of over 100,000 pages of documents and over seventy days of deposition testimony.

The SLC was created on May 24, 1996 by a TLC Beatrice board resolution.[2] At that time, Former Secretary of the Army, Clifford L.

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[2]The resolution stated that the purpose of the SLC was to:

> investigate and evaluate the allegations and issues raised in the Litigation and to prepare such report, and consider and determine whether or not continued prosecution of the Litigation is in the best interests of the Company and its stockholders and what action the Company should take with respect to the Litigation, in accordance with Delaware law.

Alexander, Jr., and the Honorable William H. Webster were elected as outside directors of TLC Beatrice and appointed to be the two members of the SLC. Prior to their appointment to the SLC, neither of these respected individuals had any association with or interest in TLC Beatrice or any of the parties to the action.

After the SLC was created, its members requested that both Carlton and the defendants agree to stay further discovery until the SLC had an opportunity to do its own investigation. However, no agreement was reached between the parties and this Court declined to stay plaintiff's opportunity to take discovery.[3] Discovery (and discovery disputes) continued throughout the five-month investigation of the SLC.

A detailed description of the SLC investigation is unnecessary for the determination of this discovery issue. Judging only from the brief the SLC has filed in support of the proposed settlement, it does appear that the SLC and its counsel conducted an extensive investigation of the claims, reviewing deposition testimony, documentary evidence, and witness interviews, and researching the legal standards applicable to each of the claims brought forth in the derivative action in order to evaluate their settlement value. During such investigation, the SLC was assisted by the Washington, D.C. office of the New York firm of Milbank, Tweed, Hadley & McCloy, in which Judge Webster appears to be a partner, and the Delaware firm of Morris, Nichols, Arsht & Tunnel, as well as an executive compensation firm, William M. Mercer, Incorporated.

As a result of the investigation and negotiations with defendants, the SLC entered into the proposed settlement with defendants, submitting the negotiated stipulation to this Court on November 12, 1996. Pursuant to the terms of the proposed settlement, the estate of Reginald Lewis has agreed to pay the Company a total of $14,932,000 plus interest, which will be paid in installments over a seven year period.

On December 23, 1996, the SLC filed a brief in support of its motion to have the proposed settlement approved by this Court, and two accompanying factual affidavits of Ms. Eichen and Mr. Tufaro. In response, Carlton filed a discovery request on January 6, 1997 which is the subject of the SLC's pending motion for a protective order.

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[3]Paul Biddelman, Carlton's representative on the Board, voted in favor of establishing the SLC but refused to consent to the stay of discovery.

II. LEGAL PRINCIPLES AND ANALYSIS

A. Document Production Requests

[4] As discussed above, it has been established that once a special litigation committee has entered into a proposed settlement with defendants, a derivative plaintiff is no longer entitled to engage in expansive discovery, but rather must tailor its discovery requests to the narrow scope of the inquiry appropriate for the stage in the proceeding. *See In re Amstead Indus., Inc., Litig.*, Del. Ch., 521 A.2d at 1107; *Zapata*, Del. Supr., 430 A.2d at 788. Under the first step of the *Zapata* test, the Court must "inquire into the independence and good faith of the committee and the bases supporting its conclusion. Limited discovery may be ordered to facilitate such inquiries." 430 A.2d at 788. As will be discussed below, discovery into the merits of the derivative plaintiff claims are generally or presumptively beyond the scope of this inquiry.[4]
[5] In *Kaplan v. Wyatt*, this Court interpreted how these broad guidelines, regarding the inquiry into the good faith and independence of the SLC and the reasonableness of its investigation, should be applied in evaluating whether a specific discovery request is appropriate. Del. Ch., 484 A.2d 501 (1984), *aff'd*, Del. Supr., 499 A.2d 1184 (1985). In *Kaplan*, the derivative plaintiff had made an extensive document request, quite analogous to Carlton's request in this action, seeking all of the documents reviewed by the SLC, as well as documents regarding the manner in which the SLC was assisted by its counsel and other expert advisors. Del. Ch., C.A. No. 6361, Brown, C. (Jan. 18, 1984) Slip Op. at 1-2. The Court held that the derivative plaintiff was not entitled to the production of the thousands of documents reviewed by the SLC, remarking that "such all-encompassing discovery is not within the spirit of *Zapata* since its mandate contemplates only such discovery as fits the occasion in the view of the Court." 484 A.2d at 511. Instead, the Court limited the derivative plaintiff's discovery to requests for information regarding the nomination of the SLC members and their affiliations with

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[4] In *Abbey v. Computer & Communications Technology Corp.*, Del. Ch., C.A. No. 6941, Brown, V.C. (April 13, 1983) at 6, the Court ruled that the derivative plaintiff was not entitled to take broad discovery, noting that "if a derivative plaintiff is to be permitted full discovery of his case under the guise of making a record in opposition to a motion to dismiss brought by a special litigation committee, what would be the need for having the special litigation committee procedure to begin with?" The efficiency of the utilization of a special litigation committee would be defeated, at least in part, by permitting full discovery on the merits by a party objecting to the committee's recommendation, without any showing of evidence that the committee did not proceed in good faith.

business organizations. In affirming this decision, the Delaware Supreme Court noted that discovery at this stage in the proceedings is "not by right, but by order of the Court," emphasizing the discretionary nature of the type and extent of discovery permitted. 499 A.2d at 1192.

[6-7] Carlton argues that it is entitled to discover documents that were denied in *Kaplan* on two main grounds. First, Carlton argues that this case is distinguishable from *Kaplan* because the SLC did not provide Carlton with a report, but rather filed a brief in support of the proposed settlement. In my opinion, the SLC's 162 page brief should not be dismissed as a piece of advocacy writing, as Carlton contends. I am firmly of the view that counsel representing a fiduciary in court has a very particular burden of candor to the court; that the excesses to which the "zealous advocacy" model of lawyer identity can lead, have no place in such representation and I assume, because of their sophistication, that the firms representing the SLC share this understanding. Thus, I regard their brief — insofar as it contains statements of fact — to have the same integrity as would any report that those lawyers made to their client. The fact that the SLC opted to prepare their report in this form, rather than spending further resources to produce a second document, does not entitle Carlton to further discovery. If Carlton wishes to challenge the SLC's statements in its brief, conclusions, or independence and good faith, Carlton has a large discovery record from which it may do so.

[8] Second, Carlton contends that, unlike the derivative plaintiff in *Kaplan*, it is not seeking merits discovery. Carlton emphasizes that it has already spent eighteen months doing extensive discovery on the merits and that it already possesses "practically the entire universe of merits-related documents and testimony that the 'SLC or its counsel' reviewed." *See* Brief in Opposition to the SLC's Motion for a Protective Order at 11 n.3. The fact that Carlton has already had an opportunity to do such discovery in this case does not, in my opinion, entitle Carlton to do the type of discovery denied to the *Kaplan* plaintiff. Rather, to avoid further wasted resources and delay, Carlton should be similarly limited in its discovery at this time. As noted in *Kaplan*, if Carlton:

> has evidentiary matter which tends to contradict the facts relied upon and disclosed by the Committee in reaching its conclusions, or facts which would tend to indicate that the Committee did not conduct its investigation in good faith, then I think the time has come for the plaintiff to bring them forth and develop them on his own as opposed to culling through hundreds or thousands of documents previously reviewed by the Committee on the pretense of attempting to

> satisfy himself that the Committee had done a good faith job and that its report and recommendations are warranted based upon that which it had before it.

Slip Op. at 7-8. After almost two years of discovery in this matter, Carlton should be well-equipped without further discovery to evaluate the independence, good faith, and reasonableness of the SLC investigation and conclusions, especially given the detailed description of the SLC investigation in its brief regarding the proposed settlement.

[9-10] In my opinion, at this stage in the proceeding, Carlton is only entitled to the production of documents narrowly related to the independence and good faith of the SLC, which Carlton has not had another prior opportunity to seek in discovery requests. Specifically, the SLC must produce those documents which relate to the creation of the SLC and appointment of its two members, and any retention letters between the SLC and its counsel and its counsel and the compensation expert. In addition, since communications between the defendants and the SLC regarding the case or its settlement may well be relevant to good faith claims, such matters are discoverable at this stage as well. As to Carlton's document production requests, therefore, the SLC's motion seeking a protective order will be granted, consistently with the foregoing.

B. Deposition Request

[11] As a general rule in Delaware, counsel to special litigation committees are not deposed regarding the assistance or advice they provide to their clients in this type of action. Primarily this is because it is the decision of the directors and their basis for their action that is centrally relevant. In *Kaplan*, the Court made it clear that under normal circumstances it would not allow a derivative plaintiff to depose counsel for a special litigation committee. Slip Op. at 8-9. The Court made an exception from this general rule, permitting counsel to be deposed, only because of the fact that one of the members of the committee had died prior to being deposed regarding the committee's investigation. *Id.*

[12] Carlton has cited several non-Delaware cases to support its argument that it should be entitled to depose Mr. Tufaro,[5] as well as

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[5]*See, e.g., Maher v. Zapata Corp.*, 714 F.2d 436 (5th Cir. 1983); *Zitin v. Turley*, No. CIV-89-2601-PHX-CAM 1991 WL 283814, at *6, Muecke, D.J. (D. Ariz. June 20, 1991) at *6; *Falkenberg v. Baldwin*, N.Y. Spec. Term, 23 Fair Empl. Prac. Cas. (BNA) 1826, 1980 WL 4655, at *2, Kirschenbaum, J. (Mar. 3, 1980).

Delaware cases involving class action settlements,[6] but I am not convinced that permitting Carlton to depose Mr. Tufaro would be appropriate under the circumstances of this case. In my opinion, the general rule as stated in *Kaplan* should govern the determination of this discovery issue. What is important at this stage in the proceedings is what the SLC knew and did during the investigation and in reaching their conclusions. This information can be obtained by Carlton in deposing the SLC members themselves. Should there be grounds to think that counsel himself acted in bad faith — manipulating the process in violation of duty in an attempt to affect the SLC deliberations — a different circumstance would be present. There is no ground to suspect that here (Milbank, it appears, was completely independent of defendants prior to the assignment[7]) or to assume such a fact, and no fishing expedition into that terrain will be permitted at this point. Therefore, the SLC's request for a protective order preventing the deposition of Mr. Tufaro will be granted.

In my opinion, this ruling should not hinder Carlton's discovery of the pertinent information concerning the investigation conducted by the SLC with the assistance of counsel. The SLC report and accompanying documents should provide a sufficient basis for Carlton to depose the SLC members themselves and determine whether the investigation was done in good faith and in an informed manner and whether the conclusions reached can be thought fair.

III. CONCLUSION

As noted above, the SLC has agreed to permit the depositions of the SLC members and compensation expert and to produce all documents concerning the creation of the SLC and appointment of its two members, as well as retention letters between the SLC and its counsel and its counsel and the compensation expert. Since I have concluded that the SLC is entitled to a protective order barring all other document discovery requested by Carlton (except communication by the SLC with defendants concerning the claims or settlement) and barring the deposition of Mr.

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[6]*See, e.g., In re Mobile Communications Corp. Consol. Litig.*, Del. Ch., C.A. No. 10627, Allen, C. (Oct. 16, 1989) Slip. Op. at 3; *In re Resorts International Shareholders Litig.*, Del. Ch., C.A. No. 9479, Allen, C. (Aug. 3, 1988) (bench ruling); *Sullivan v. Hammer*, Del. Ch., C.A. No. 10823, Hartnett, V.C. (Mar. 5, 1990).

[7]The suggestion in a recent letter from plaintiff's counsel that Milbank's lead lawyer in the assignment, Mr. Tufaro, was a former partner of Thomas Puccio, Esquire — who represented one of the defendants briefly and in a manner that deserved judicial disapproval — does not itself justify a deposition of Mr. Tufaro.

Tufaro, no discussion of the application of attorney client or work product privilege is necessary. Discovery should continue promptly within these constraints in preparation for the upcoming hearing on the proposed settlement.

IN RE CHEYENNE SOFTWARE, INC. SHAREHOLDERS LITIGATION

No. 14,941 (Consolidated)

Court of Chancery of the State of Delaware, New Castle

November 7, 1996
Revised November 8, 1996

Plaintiff shareholders filed suit for a preliminary injunction seeking to enjoin the closing of a tender offer. The shareholders alleged that defendant, board of directors, failed to exercise due care and did not disclose material information to the shareholders in connection with the accepted tender offer. Plaintiffs further asserted breach of fiduciary duty and claimed that the board of directors acted hastily by failing to question the bases for a discount rate in its cash flow analysis, and by improperly rejecting a tender offer made by a larger company. Defendants argued that no evidence exists that they failed to act on an informed basis or without reasonable care in their search for an alliance with a larger company. Accordingly, defendants sought to have the plaintiffs' claim for injunctive relief denied.

The court of chancery, per Vice-Chancellor Chandler, held that the plaintiffs had no reasonable probability of success on the merits, and concluded that the balance of hardships tipped in defendants' favor. The court, therefore, denied the plaintiffs' request for a preliminary injunction.

1. Injunction ⚷ 138.21, 151

To obtain preliminary injunctive relief, plaintiff must show (1) that the action has a reasonable probability of ultimate success on the merits; (2) that absent an injunction, plaintiffs will suffer immediate and irreparable harm; and (3) that the harm that would be suffered by

plaintiffs if the injunction were to be denied outweighs the harm that would be suffered by defendants if the injunction were to be granted.

2. Corporations ⟹ 307, 310(1)

To satisfy the fiduciary duty of care, a board of directors is required to act on an informed basis.

3. Corporations ⟹ 310(1), 310(2)

Determination of whether business judgment of board of directors was informed turns on whether directors have informed themselves, prior to making a business decision, of all material information reasonably available to them.

4. Corporations ⟹ 310(1), 310(2)

Directors are protected from a breach of the duty of due care when the directors reasonably believe the information upon which they rely has been presented by an expert selected with reasonable care and is within that person's professional or expert competence. DEL. CODE ANN. tit. 8, § 141(e) (1991).

5. Corporations ⟹ 310(2)

When determining whether a board's decision is protected under the business judgment rule, plaintiffs must show that the board acted with gross negligence to overcome the presumption that the directors acted on an informed basis.

6. Injunction ⟹ 138.18

Where plaintiffs fail to establish that their duty of care claim has a reasonable chance of ultimate success on the merits by failing to show a reasonable probability that they can prove the board acted hastily or in an uninformed fashion, plaintiffs fail to meet the first standard required for a preliminary injunction.

7. Corporations ⚷ 194

A board of directors must fully and fairly disclose all material facts within its control that would have a significant effect upon a stockholder vote.

8. Corporations ⚷ 194

The board of directors is not required to provide all available information, only that which a reasonable investor would view as having significantly altered the total mix of information available.

9. Injunction ⚷ 138.15

To successfully obtain a preliminary injunction, plaintiffs must show that the harm they would suffer if the preliminary injunction were denied outweighs the harm defendants would suffer if an injunction were granted.

10. Injunction ⚷ 138.1, 138.12

A preliminary injunction will not issue to restrain a third-party tender offer at a substantial premium over market in the absence of special circumstances which warrant such action by the courts.

11. Injunction ⚷ 138.15, 138.21

When analyzing the balance of harm in a situation in which there is no alternative transaction and issuance of the injunction inescapably involves a risk that the shareholder will be detrimentally affected, the court requires a special conviction about the strength of the legal claim asserted, as well as a strong sense that the risk to the shareholder is small before it will grant the injunctive relief requested.

12. Injunction ⚷ 138.12, 138.15

Balance of hardships will overwhelmingly tip in favor of defendant board to deny a preliminary injunction where a court feels no special conviction about the strength of the plaintiffs' legal claims and where a significant risk exists that shareholders may lose a limited opportunity to sell their stock at a substantial premium if an injunction were issued.

Pamela S. Tikellis, Esquire, and James C. Strum, Esquire, of Chimicles, Jacobsen & Tikellis, Wilmington, Delaware; Joseph A. Rosenthal, Esquire, of Rosenthal Monhait Gross & Goddess, P.A., Wilmington, Delaware; Stanley D. Bernstein, Esquire, of Bernstein Liebhard & Lifshitz, New York, New York, of counsel; Jon Plasse, Esquire, of Goodkind Labaton Rudoff & Sucharow, LLP, New York, New York, of counsel; Law Offices of Bernard M. Gross, P.C., Philadelphia, Pennsylvania, of counsel; Law Office of Dennis Johnson, South Burlington, Vermont, of counsel; Kaufman Malchman Kirby & Squire, LLP, New York, New York, of counsel; Malina & Wolson, New York, New York, of counsel; Savett Frutkin Podell & Ryan, P.C., Philadelphia, Pennsylvania, of counsel; Wechsler Harwood Halebian & Feffer, LLP, New York, New York, of counsel; Wolf, Haldenstein, Adler, Freeman & Herz, LLP, New York, New York, of counsel; and Zwerling Schachter Zwerling & Kopell, New York, New York, of counsel, for plaintiffs.

Wayne N. Elliott, Esquire, James L. Holzman, Esquire, and Elizabeth M. McGeever, Esquire, of Prickett, Jones, Elliott, Kristol & Schnee, Wilmington, Delaware, for defendant Computer Associates International, Inc.

Kenneth J. Nachbar, Esquire, and Donna L. Culver, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware; and Wachtell Lipton Rosen & Katz, New York, New York, of counsel, for defendants Reijane Huai, Rino Bergonzi, Richard F. Kramer, Bernard Rubien, Ginette Wachtel, and Cheyenne Software, Inc.

CHANDLER, *Vice-Chancellor*

Asserting breach of the fiduciary duties of due care and full disclosure by a target board of directors, shareholders seek to enjoin the closing of a tender offer that expires at midnight November 8. The all-cash, all-shares offer for $32.50 per share is at a substantial premium over the pre-offer market price. Finding no reasonable probability of success on the merits and concluding that the balance of hardships tips in defendants' favor, I deny the shareholders' application for injunctive relief.

I. BACKGROUND

In late 1995, Computer Associates International, Inc. ("Computer Associates") expressed an interest in acquiring Cheyenne Software, Inc.

("Cheyenne"). About the same time, Cheyenne's management decided that Cheyenne's long-term interests would be best served through an alliance with a larger company. To explore whether companies other than Computer Associates might also have an acquisition interest, Cheyenne, through an investment banking firm specializing in the technology sector, contacted seven other potential acquirors. None of these companies, however, expressed an interest in acquiring Cheyenne.

In March 1996, Cheyenne's stock price dropped in one day, from $23 per share to $15 per share, in response to Cheyenne's announcement that its quarterly income would be less than expected. Shortly thereafter, McAfee Associates, Inc. ("McAfee") made an unsolicited stock-for-stock merger proposal. While the nominal value of the offer, based on the prevailing price of McAfee's stock, was $27.50, Cheyenne's Board of Directors believed that the merger would not be a good strategic fit and that McAfee's stock price would decline if the merger succeeded. Thus, Cheyenne's Board valued the McAfee offer at $24 per share and voted unanimously to reject the proposal. On April 16, plaintiffs filed a class action lawsuit against Cheyenne and its Board of Directors, alleging that they improperly rejected the McAfee proposal.

When representatives of Cheyenne and Computer Associates met in June 1996 to discuss Cheyenne's possible sale, Computer Associates indicated that it would not pay more than the amount McAfee had offered. In September, however, Computer Associates offered $30 per share in cash. Cheyenne's Board discussed the offer with its legal and financial advisors, Lazard Freres & Co. LLC ("Lazard Freres") and Wachtell Lipton Rosen & Katz ("Wachtell Lipton"), and reached a preliminary conclusion that $30 per share or more in cash would be a fair offer to Cheyenne's shareholders. The Board did not make an attempt to contact other potential bidders because Cheyenne had previously contacted seven other potential acquirors in late 1995 and no other offer had developed since that time. The Board also believed that contacting further bidders might jeopardize the opportunity to sell Cheyenne to Computer Associates.

During a meeting on October 6, 1996, Computer Associates raised its cash offer to $30.30 per share. After Cheyenne's Chairman, President and CEO, Reijane Huai, suggested $32.50 per share, Computer Associates lowered its bid to $28.50 per share. That afternoon, Cheyenne's Board consulted with Lazard Freres and Wachtell Lipton, and decided to reject the offer as inadequate. That evening, Computer Associates again offered $30.30 per share and indicated that it would publicly announce its offer the next day.

Cheyenne's stock was trading at $22. Fearing that a hostile tender offer by Computer Associates at $30.30 per share would succeed, and knowing that McAfee's $27.50 stock-for-stock proposal had been the only other offer available, Huai nonetheless decided to meet again with Computer Associates in a final attempt to improve the offer. Shortly after midnight, October 7, Computer Associates raised its offer to $30.50. This offer was unanimously approved by the Board after a ninety-minute meeting in the early hours of October 7, during which the Board was advised by Lazard Freres that the proposal was fair to Cheyenne's shareholders. Cheyenne's Board unanimously approved the final merger agreement that same day and the transaction was publicly announced. The

[start - revised page - November 8, 1996]

agreement contained a "fiduciary out" permitting Cheyenne to receive higher unsolicited offers from third parties. It also contained a $37.5 million termination fee payable if Cheyenne's Board withdrew its approval of the merger or if Cheyenne was acquired by another party. On October 11, Computer Associates, through it subsidiary, commenced the offer to purchase and Cheyenne filed its 14D-9 recommending that Cheyenne shareholders tender their shares. On October 18, plaintiffs filed an amended class action complaint alleging that Cheyenne's Board failed to exercise due care and failed to disclose material information to Cheyenne shareholders in connection with Computer Associates' tender offer. On November 6, I heard oral argument on plaintiffs' motion for a preliminary injunction to enjoin the tender offer, which closes at midnight November 8.

II. LEGAL STANDARD FOR A PRELIMINARY INJUNCTION

[1] The standard for a preliminary injunction consists of three separate elements. Plaintiffs must show (1) that the action has a reasonable probability of ultimate success on the merits, (2) that absent an injunction, plaintiffs will suffer immediate and irreparable harm, and (3) that the harm that would be suffered by plaintiffs if the injunction were to be denied outweighs the harm that would be suffered by defendants if the injunction were to be granted.[1]

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[1]*Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, Del. Supr., 506 A.2d 173, 179 (1986).

[start - revised page - November 8, 1996]

III. ANALYSIS

A. The Cheyenne Directors' Duty of Due Care

[2-5] Plaintiffs allege that Cheyenne's directors breached their fiduciary duty of due care by acting hastily and by failing to question the bases for Lazard Freres' use of a 21% discount rate in its cash flow analysis. The duty of care requires directors to act on an informed basis.[2] Whether directors have acted on an informed basis depends upon "whether the directors have informed themselves 'prior to making a business decision, of all material information reasonably available to them'"[3] Section 141(e) of Delaware's corporation law provides that directors are protected from a breach of the duty of due care when the directors reasonably believe the information upon which they rely has been presented by an expert "selected with reasonable care" and is within that person's "professional or expert competence." Furthermore, the decision of a board to accept or reject a tender offer is protected by the business judgment rule. Thus, to overcome the presumption that the directors acted on an informed basis, plaintiffs must show that the Board acted with gross negligence.[4]

[6] Plaintiffs have not established that their duty of care claim has a reasonable chance of ultimate success on the merits. Nothing in this record indicates that Lazard Freres was not selected with reasonable care or that the information they presented to the Board was not within their expert competence. Nor is there evidence that the Board failed to adequately examine the Lazard Freres' book that was reviewed by Mr. Rosenfeld, a managing director of Lazard Freres, with the Board on October 7. In that meeting, Mr. Rosenfeld explained the reasons behind Lazard Freres' use of a 21% discount rate as well as the impact that different discount rates would have upon the share price. Minutes of the Board meeting reveal that Mr. Rosenfeld discussed the strengths and weaknesses of four different share price ranges resulting from four different combinations of discount rates and growth rate projections provided by both Cheyenne management and computer industry analysts. Finally, there is no indication that the Board acted hastily. Cheyenne's Board had considered a sale or other business combination since late

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[2] *Cede & Co. v. Technicolor, Inc.*, Del. Supr., 634 A.2d 345, 367 (1993).

[3] *Smith v. Van Gorkom*, Del. Supr., 488 A.2d 858 (1985), citing *Kaplan v. Centex Corp.*, Del. Ch., 284 A.2d 119, 124 (1971).

[4] *Smith v. Van Gorkom*, Del. Supr., 488 A.2d 858, 872 (1985).

1995. It had approached seven other potential bidders and retained two investment banks and legal counsel for advice. Finally, although the company was the subject of takeover rumors, McAfee and Computer Associates were the only companies to make a bid. In sum, plaintiffs have not shown a reasonable probability that they can prove the Board acted hastily or in an uninformed fashion. Thus, plaintiffs' duty of care claim fails to meet the first standard required for a preliminary injunction.

B. The Cheyenne Directors' Duty to Fully Disclose Material Information

[7-8] A board of directors must fully and fairly disclose "all material facts within its control that would have a significant effect upon a stockholder vote."[5] The board is not required to provide all available information, however, just that which a reasonable investor would view as "as having significantly altered the 'total mix' of information made available."[6]

The heart of plaintiffs' complaint is the allegation that Cheyenne's 14D-9 did not provide the reasons for Lazard Freres' use of a 21% discount rate and that such information would have significantly altered the "total mix" of information available by revealing to shareholders that Lazard Freres' opinion contained a "misleading statement." In support of their claim, plaintiffs point to Lazard Freres' opinion which states that Lazard Freres assumed that the projections of Cheyenne's management were "reasonably prepared on bases reflecting the best currently available estimates and judgments of management of the Company as to the future financial performance of the company." This statement is misleading, according to plaintiffs, because Lazard Freres based its justification for adding four percentage points to the seventeen percent industry average cost of capital on its belief that management's estimates were higher than analyst's projections and its mistaken impression that Cheyenne had failed to meet management's projections since 1993.

As noted by defendants, however, there is no inconsistency between Lazard Freres' assumption that management's projections were "reasonably prepared on bases reflecting the best currently available estimates and judgments" and Lazard Freres' belief that the risk inherent in that "best currently available" information warranted the use of a higher discount rate. The statement is not misleading. Currently

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[5]*Stroud v. Grace*, Del. Supr., 606 A.2d 75, 85 (1992).

[6]*Rosenblatt v. Getty Oil Co.*, Del. Supr., 493 A.2d 929, 945 (1985), citing *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

available projections still may be subject to special risks--reflected in the higher discount rate--because of the nature of the computer software industry. On this record, therefore, I cannot accept plaintiffs' claim that additional information regarding the discount rate would significantly alter the total mix of information already available to Cheyenne's shareholders.

C. The Balance of Hardships

[9] In addition to plaintiffs' failure to demonstrate a likelihood of success on the merits of their claims, they have also failed to show that the harm they would suffer if the preliminary injunction were denied outweighs the harm defendants would suffer if an injunction were granted. On this alternate ground, therefore, injunctive relief also should be denied.

It is undisputed that Computer Associates' $30.50 per share tender offer represents a significant premium over Cheyenne's historical market price. Computer Associates' final offer is the result of intensive, arms-length negotiations. Cheyenne had been "in play" for months, and only one other company, McAfee, made an offer--a stock for stock proposal with no collar that was significantly less advantageous for Cheyenne shareholders. Computer Associates' proposal is an all-cash offer at a premium over market, with $30.50 available for all shares tendered now or acquired in the follow-up merger. Not only is Computer Associates' offer a substantially greater value than any other offer, it is undisputedly the only offer now available to Cheyenne's shareholders. No other company has even made an inquiry since Computer Associates' proposal was announced on October 7. Computer Associates has committed $1.2 billion in cash to make it tender offer, which closes on November 8. It will incur substantial costs if the closing date is delayed by an injunction. Moreover, the merger agreement contains an "injunction out" providing Computer Associates the opportunity to revoke its offer if it is judicially restrained. Computer Associates' representative has stated that the price will not be renegotiated and that Computer Associates has no reason to extend its offer in the event an injunction were issued.[7] Thus, Cheyenne has no assurance that if I were to issue an injunction, Computer Associates will voluntarily extend its offer.

Plaintiffs insist that a minor delay in the tender offer closing date would risk little, if any, harm to defendants, and yet would afford

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[7]S. Kumar Affidavit ¶ 20.

Cheyenne's Board an opportunity to investigate the transaction more fully and to provide additional information to shareholders. Furthermore, plaintiffs contend that shareholders who are concerned about receiving their $30.50 per share can obtain virtually all of that amount in the market, which has responded to Computer Associates' offer by driving Cheyenne's stock slightly above $30 per share.

[10-11] A number of cases in this Court have held that, absent special circumstances not present here, a preliminary injunction will not issue to restrain a third-party tender offer at a substantial premium over market. As Chancellor Allen said in *Solash v. Telex Corp.*:[8]

> [T]he balance of harm in this situation in which there is no alternative transaction and issuance of the injunction inescapably involves a risk that the shareholders will lose the opportunity to cash in their investment at a substantial premium requires not only a special conviction about the strength of the legal claim asserted, but also a strong sense that the risk in granting the preliminary relief of an untoward financial result from the stockholders' point of view is small. Repeatedly the plaintiffs' class action bar exhorts the court to bravely risk the consequences in circumstances such as these, asserting that more money to the shareholders, not less, will probably result. At least on facts such as these, a due respect for the interests of the class on whose behalf these exhortations are made, requires, in my judgment, that the invitations be declined.

[12] Feeling no "special conviction" about the strength of plaintiffs' legal claims and mindful of the significant risk that Cheyenne's shareholders may lose a limited opportunity to sell their stock at a substantial premium if an injunction were issued, I conclude that the balance of hardships tips overwhelmingly in favor of defendants. Furthermore, I cannot accept plaintiffs' suggestion that shareholders may avoid this risk by immediately selling into the price-adjusted market. This suggestion is based on the flawed assumption that the market price of Cheyenne's stock will not react negatively to news that Computer Associates' tender offer has been enjoined or that Computer Associates has refused to extend its offer. For all of these reasons, I deny plaintiffs' application for a preliminary injunction.

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[8]Del. Ch., C.A. Nos. 9518, 9525 and 9528, Allen, C. (Jan. 19, 1988), slip op. at 33.

IT IS SO ORDERED.

CREDIT LYONNAIS BANK NEDERLAND, N.V.
v. PATHE COMMUNICATIONS CORP.

No. 12,150

Court of Chancery of the State of Delaware, New Castle

December 20, 1996

Defendants, a Delaware corporation and its controlling agent, filed a motion to reopen a final judgment entered against them in 1992. The final judgment declared the legal effectiveness of actions taken by the Plaintiffs, a credit institution. Defendants presented several affidavits as new evidence. Plaintiffs sought an award of attorneys' fees and costs reasonably incurred in defending against this motion.

The court of chancery, per Chancellor Allen, denied defendants' motion to reopen final judgment because: (1) the affidavits did not assert any specific document improperly withheld from the court (2) the claim of false testimony showed nothing more than an individual choosing his words carefully when testifying and (3) the defendants produced no new evidence that would persuade the court that it would have probably changed its decision were the new information considered in context of the whole record. Attorneys' fees and costs were denied to the plaintiffs because they were unwarranted.

1. Federal Civil Procedure ⟹ 2646

Court of Chancery Rule 60(b), like the federal rules of civil procedure, provides that upon such terms as are just, the Court may relieve a party or a party's legal representative from a final judgment. DEL. CH. CT. R. 60(b).

2. Federal Civil Procedure ⚷ 2654

Court of Chancery Rule 60(b)(3) allows relief from a final judgment in cases of fraud, misrepresentation, or other misconduct of an adverse party. DEL. CH. CT. R. 60(b)(3).

3. Federal Civil Procedure ⚷ 2350, 2655

Court of Chancery Rule 60(b)(2) allows relief from judgment on the basis of newly discovered evidence. DEL. CH. CT. R. 60(b)(2).

4. Federal Civil Procedure ⚷ 2641

Court of Chancery Rule 60(b) implicates the following two values: the integrity of the judicial process, which the rule exists to serve, and the finality of judgments, which its adminstration must acknowledge. DEL. CH. CT. R. 60(b).

5. Federal Civil Procedure ⚷ 2655, 2662

A movant under Rule 60(b) bears the burden to show evidence of fraud or new evidence of such a material nature that it would convince the court that it would probably change its decision had it known of the transgressions or improprieties committed during the proceedings. DEL. CH. CT. R. 60(b).

6. Contracts ⚷ 168

Undermining the authority of a chief executive officer, attempting to assert control over financial, legal and personnel functions, making threats, convening board meetings without a quorum present which attempted to seize corporate power, and failing to disclose material financial information, constitute a breach of good faith and fair dealing which are foundational requirements of all contracting parties.

7. Federal Civil Procedure ⚷ 2654, 2655, 2662

To succeed in a motion to reopen a final judgment the movant must present strong evidence that the course of dealing either did not occur or that new evidence made the movant's actions justifiable.

8. Federal Civil Procedure ⚷ 2655

Under Court of Chancery Rule 60(b), affidavits, which state factors that were obvious and known at the time of the trial and do not assert the existence of any specific document that was improperly withheld from the court, do not constitute new evidence to support a motion to reopen a final judgment. DEL. CH. CT. R. 60(b).

9. Federal Civil Procedure ⚷ 2647, 2655

Rule 60(b) is a remedy for circumstances in which new evidence shows that an injustice is clearly threatened. DEL. CH. CT. R. 60(b).

10. Federal Civil Procedure ⚷ 2659, 2662

A motion to reopen a final judgment requires the moving party to persuade the court, with new information, that it would probably change its decision were the new information considered in the context of the whole record.

11. Federal Civil Procedure ⚷ 2655, 2662

A court should not grant a motion to reopen a final judgment unless it is persuaded by the new evidence that more likely than not it would find for the moving party on retrial.

12. Federal Civil Procedure ⚷ 2723, 2724, 2737.3

If a party has acted in bad faith or vexatiously, the court may exercise its equitable powers to award attorneys' fees to the opposing party. DEL. CODE ANN. tit. 10, § 5107 (1996).

13. Federal Civil Procedure ⚷ 2724, 2737.1, 2737.3

The court's exercise of its equitable powers to make an award of attorneys' fees to a party, where the opposing party is found to have acted in bad faith or vexatiously, is not a normal practice nor is it done lightly.

14. Federal Civil Procedure ⟹ 2723

Before awarding attorneys' fees, the court has the discretion to allow the parties the opportunity to introduce evidence on that subject.

15. Costs ⟹ 194.12
Federal Civil Procedure ⟹ 2723, 2737

It is within the court's discretion to deny attorneys' fees even where the opposing party has filed a motion for strategic reasons and it lacks a substantial basis.

Sam Nolen, Esquire, of Richards, Layton & Finger, Wilmington, Delaware, for plaintiffs.

Lawrence Hamermesh, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for defendants.

ALLEN, *Chancellor*

Pending is a motion under Rule 60(6) to reopen the 1992 final judgment entered in this energetically contested litigation arising from the near-collapse of MGM-Pathe Communications Co. ("MGM"), after it was bought in a highly leveraged transaction by Pathe Communications Corporation ("Pathe"), a company controlled by defendant Giancarlo Parretti. The central issue in the case was whether Mr. Parretti breached a contract, the "Corporate Governance Agreement" which he entered into with his primary lender in the leveraged buyout, Credit Lyonnais Bank Nederland. The facts alleged to constitute that breach principally occurred soon after Mr. Parretti assumed active control over MGM and rapidly drove it to the brink of bankruptcy. I found after a lengthy trial that Parretti had indeed violated the Agreement on numerous occasions, and consequently that Credit Lyonnais had the right under its various agreements with Parretti and Pathe to vote Parretti's controlling stock in Pathe and Pathe's controlling stock in MGM.[1] As a result the Court

[1]The Corporate Governance Agreement was accompanied by a Voting Trust Agreement, by which Parretti gave Credit Lyonnais the right to vote his controlling shares in Pathe and MGM. However, Credit Lyonnais agreed it would not exercise its voting rights as long as Parretti and MGM remained in compliance with the Corporate Governance Agreement. Plaintiffs accused the defendants of acting from the outset to undermine the Corporate Governance Agreement and retain operating control of MGM and Pathe. Plaintiffs consequently foreclosed on Pathe's MGM stock and voted to oust Parretti and his nominees