number of shares to be issued to the Insiders, to 646,734 shares. When issued, those shares would constitute 26.5% of Ventana's equity. According to the Preliminary Prospectus issued in connection with Ventana's July, 1996 initial public offering, the stock was issued to Messrs. Patience and Schuler in connection with (i) their efforts in completing the BioTek acquisition and assisting management with the integration of the companies, (ii) Schuler's agreement to serve as Chairman of Ventana's board, and (iii) Schuler's and Patience's devotion of significant work to Ventana's board.[7] The complaint alleges that the board made no valuation of the services for which these shares were being issued. The board did determine, however, that the "fair market value" of the to-be-issued Ventana common stock was the $1.62 per share issuance price to the Insiders.

During the February 23, 1996 meeting, the board also approved a memorandum that outlined the principal elements of the stock sale to the Insiders (the "Memorandum"). Those elements included two Conditions that are relevant to these motions. Condition 3 stated that:

> "[t]he valuation used by Ventana as a basis for valuing its Common Stock, at a price of $.60 per share, shall not be determined subsequently by the Securities and Exchange Commission ("SEC"), in the event of an initial public offering by the Company of its Common Stock, as "Cheap Stock" and therefore subject to excess compensation accounting and disclosure requirements."

And Condition 6 provided that:

> "[i]n the event any stockholder holding 10% or more of the Company's stock (on an as converted basis) initiates litigation with respect to the [Insider Sale], Jack W. Schuler and Crabtree Partners shall indemnify and hold harmless Ventana and its directors and executive officers from costs of defending such litigation and from any damages or settlement paid as a result of such litigation."

The relevance of these Conditions will later appear.

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[7]The complaint alleges (at ¶ 15) that the stock was being issued in the exchange for the defendants' services, but does not particularize the services. That information appears in the Preliminary Prospectus (Raju Aff., Ex. A at 58), which is incorporated by reference into the complaint. (See Complaint at ¶26). The plaintiff, in his brief, does not dispute the substance of the disclosures made by Ventana with respect to the services for which the Insiders were being compensated.

As earlier noted, the Ventana Exchange Notes received in the Merger provided a 30-day post-merger conversion window during which those holders could convert none, some, or all of their Notes into Ventana common stock for $13.53 per share. The plaintiff claims that at the time that the Ventana Notes were converted, he and the other Noteholders were unaware that the Insider Sale at
$1.62 per share had been authorized several weeks earlier. The plaintiff claims that had he and the other class members known that, he would have elected not to convert any of his Ventana Exchange Notes into Ventana shares, because the Insider Sale would have diluted Ventana's shares by over 25%. Unaware of the Insider Sale, the plaintiff (and other Noteholders) made no election and as a result, one-half of the face amount of the plaintiff's Ventana Exchange Notes ($31,041.36) was automatically converted into 2,295 shares of Ventana common stock on March 26, 1996.

In April and May 1996, the Insider Sale that had been authorized four months earlier was consummated, by Ventana issuing 646,734 shares of stock to the Insiders for $1.62 per share. The plaintiff alleges that he and the other Noteholders did not learn of the Insider Sale until it was disclosed for the first time in the Ventana Preliminary Prospectus, dated July 3, 1996, that was issued in connection with the initial public offering of Ventana stock. That Prospectus also disclosed that in connection with the Insider Sale, the Director Defendants had determined that the fair market value of Ventana's common stock as of January 1996 was $1.62 per share.

This action followed. [8]

II. THE CLASS CLAIMS

[1-2] I first address the legal sufficiency of the class claims, which the defendants have moved to dismiss under Rule 12(b)(6). Under that Rule, a claim will be dismissed where it is clear from the allegations of the complaint that the plaintiffs would not be entitled to relief under any set of facts that could be proved to support the claim.[9] All well-pleaded facts alleged in the complaint will be accepted as true, but inferences and conclusions that are unsupported by specific factual allegations will not be.[10]

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[8]The filing of this action was preceded by the filing, by the plaintiff's relatives, of a lawsuit in the United States District Court for the District of Delaware ("the Federal Action"). The Federal Action asserts claims attacking the Insider Sales under the Securities Exchange Act of 1934, and also under California statutory and common law.

[9]In re Tri-Star Pictures, Inc. Litig., Del. Supr., 634 A.2d 319, 326 (1993); see also Loudon v. Archer-Daniels-Midland Co., Del. Supr., 700 A.2d 135, 140 (1997).

[10]See id.; see also In re Wheelabrator Technologies Inc. Shareholders Litig., Del. Ch., C.A. No. 11495, Jacobs, V.C., Mem. Op. at 4 (Sept. 1, 1992) (citing Grobow v. Perot, Del. Supr., 539 A.2d 180, 187 n.6 (1988)); Weinberger v. UOP, Inc., Del. Ch., 409 A.2d 1262, 1264 (1979).

On a Rule 12 (b)(6) motion the Court will also consider all documents that are incorporated into the complaint by reference.[11]

The thrust of the class claims is that the Ventana board breached their contractual and fiduciary duties by failing to disclose to the then-BioTek noteholders that one month earlier, the Ventana board had authorized the sale to the Insiders of 646,734 shares at $1.62 per share. That undisclosed fact, it is claimed, was highly material because had it been disclosed, the plaintiff and the other Noteholders would have voted against the Merger, or elected to not convert their Ventana notes into (highly diluted) shares of Ventana. The plaintiff claims that Ventana's directors had both a contractual duty under the Note Exchange Agreement, as well as a fiduciary duty under Delaware law, to disclose the authorization of the Insider Sale to BioTek Noteholders when seeking their approval of the Merger in February, 1996.

The defendants argue that the disclosure claims are legally insufficient because: (1) the Note Exchange Agreement did not impose any contractual disclosure obligation, running in favor of the BioTek Noteholders, upon Ventana's directors, and (2) the directors had no fiduciary duty of disclosure to the (former) BioTek noteholders because (a) the directors were not fiduciaries of those noteholders at the time the disclosure was (arguably) required, and (b) the claim that the directors "voluntarily assumed" a fiduciary duty is without any basis in law.

These contentions frame two issues. The first is whether the Note Exchange Agreement imposed a contractual duty of disclosure upon the Ventana Director defendants. The second is whether the Director Defendants -- who admittedly were not fiduciaries of the BioTek noteholders -- nonetheless voluntarily assumed a fiduciary duty of disclosure to them.

A. The Breach of Contract Claim (Count IV)

The first issue -- whether the Note Exchange Agreement imposed a contractual duty of disclosure upon Ventana's Directors -- arises because it is undisputed the Note Exchange Agreement, standing alone, imposed no disclosure duty upon the Ventana board. The only contract document that did arguably impose a disclosure duty is the Reorganization Agreement, which (together with the Information Statement) was one of the documents furnished in connection with obtaining the BioTek noteholders' approval of the Merger.

The Reorganization Agreement contains two provisions that, plaintiff claims, required Ventana's directors to disclose the authorization of the

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[11]See, e.g., Vanderbilt Income and Growth Assocs., L.L.C. v. Arvida/ JMB Managers, Inc., Del. Supr., 691 A.2d 609, 613 (1996).

Insider Sale. Section 4.5 recites the number of authorized and outstanding shares of Ventana's common and preferred stock, and goes on to state that Ventana expected in the future to increase that number of shares by 1,860,500 shares of Series D Preferred Stock. The plaintiff alleges that the undisclosed authorization of the sale of almost 647,000 shares to the Insiders made that representation untrue, and as a consequence, triggered the second relevant provision of the Reorganization Agreement, Section 4.7. That latter Section provides:

> No representation or warranty made by Ventana in this Article IV or in any other Article or Section of this Agreement, or in any certificate, schedule or other document furnished or required to be furnished by Ventana pursuant hereto, contains or will contain any untrue statement of a material fact or omits or will omit to state any material fact necessary to make the statements or facts contained herein or therein not misleading in light of the circumstances under which they are made. (emphasis added)

The claim that plaintiff advances here is that the nondisclosure of the board's authorization of the Insider Sale rendered Section 4.5 false, which (in turn) operated as a breach of Section 4.7, which (in turn) proscribed any untrue statement of a material fact in connection with any representation, warranty, or any certificate, schedule or "other document" furnished by Ventana.

The difficulty with this claim is that the plaintiff was not a party to the Reorganization Agreement, and he therefore lacks standing to enforce it. Recognizing that, the plaintiff urges that the Reorganization Agreement, (including Section 4.7) was incorporated by reference into the Note Exchange Agreement to which the plaintiff was a party. The defendants dispute this. They contend that the Reorganization Agreement was not incorporated by reference into the Note Exchange Agreement. These disputed contentions make the "incorporation by reference" issue pivotal to the plaintiff's contractual disclosure claim.

The precise issue, which both sides agree is governed by California law, is whether the parties intended the Note Exchange Agreement to be the exclusive expression of their agreement.[12] I conclude that the parties so intended, and that the Reorganization Agreement was incorporated into the

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[12]City of Manhattan Beach v. The Superior Court of Los Angeles County, Cal. Supr., 914 P.2d 160, 164 (1996) ("the primary object of all interpretation is to ascertain and carry out theintention of the parties").

Note Exchange Agreement, but only for the very limited purpose of defining certain terms.

[3] The Note Exchange Agreement contains a "merger" or "integration" clause. Section 6.4 provides that: "[t]his Agreement embodies the entire understanding and agreement between the Noteholder and the Company and supersedes all prior agreements and understandings relating to the subject matter hereof." Under California law, an integration or merger clause is regarded as conclusive evidence that "the parties intended the written instrument to serve as the exclusive embodiment of their agreement."[13]

[4] The plaintiff argues that because the Note Exchange Agreement refers to the Reorganization Agreement in several places, the Court must conclude that the parties intended to incorporate the entire Reorganization Agreement into the Note Exchange Agreement. But the conclusion does not follow from the premise. Under California law, where a contract refers to another writing for a particular specified purpose, that other writing becomes part of the contract for the specified purpose only.[14] That is because if the contracting parties intended to incorporate the entire Reorganization Agreement into the Note Exchange Agreement, they could have explicitly so provided. Other merger clauses have been specifically worded to incorporate other documents by reference.[15] Because there is no clear expression of an intent to incorporate the entire Reorganization Agreement into the Note Exchange Agreement, I conclude that the California courts would limit any incorporation by reference of the Reorganization Agreement to the definitions that were specifically incorporated by reference in the Note Exchange Agreement. Because the premise of Count IV -- that the entire Reorganization Agreement was incorporated by reference -- is legally incorrect, that Count must be dismissed.

B. The Beach of Fiduciary Duty of Disclosure Claim (Count V)

Count V alleges that the Director Defendants voluntarily assumed a fiduciary duty of disclosure, which they breached by failing to disclose their authorization of the Insider Sale. The plaintiff concedes that no fiduciary duty was owed to him as a debt holder at the time he was asked to approve the Merger in February, 1996, because he was not then a stockholder of Ventana and did not become one until March 26, 1996. What the plaintiff contends is that the Director Defendants, even though they were not

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[13] Airs Int'l, Inc. v. Perfect Scents Distribution, Ltd., 902 F. Supp. 1141, 1146 (N. D. Cal. 1995).

[14] Valley Constr. Co. v. City of Calistoga, Cal. App., 165 P.2d 521, 522 (1946).

[15] See e.g., Bionghi v. Metropolitan Water Dist. of S. California, 70 Cal. App. 4th 1358, 1362-63 (1999).

fiduciaries, voluntarily *assumed* a fiduciary of duty of disclosure to those noteholders when they solicited the BioTek noteholders' approval of the Merger. That claimed assumption of a fiduciary duty is said to arise from two circumstances: (1) the Directors' possession of superior knowledge about Ventana's financial condition (about which the BioTek Noteholders knew little, because Ventana was then privately owned); and (2) the Ventana Directors' representation in Section 4.7 of the Reorganization Agreement that no untrue representations would be made.

[5] In my opinion this claim is also legally unsupported. No Delaware case cited to me has imposed a fiduciary duty of disclosure upon a corporate director who did not occupy a fiduciary relationship to the persons claiming entitlement to the disclosure. Nor do the facts alleged in the complaint persuade me that this is a proper occasion to adopt plaintiff's unprecedented legal theory.

[6] It is well established in Delaware that to successfully state a claim for breach of the fiduciary duty of disclosure, the plaintiff must have been owed a fiduciary duty at the time of the alleged breach.[16] In Sanders v. Devine,[17] the plaintiff alleged that the directors had breached their fiduciary duty of disclosure by failing to disclose certain information in the prospectus pursuant to which preferred stock had been issued and sold to the public. Rejecting that claim, Vice Chancellor Lamb held:

> In order to prevail on a breach of fiduciary duty claim, plaintiff Sanders must first establish that at the time the Prospectus was issued he was a person to whom a fiduciary duty was owed. In the present case, plaintiff was not a stockholder at the time the prospectus was issued, therefore, as a matter of law, there can be no liability under any fiduciary duty theories for the disclosures made in connection with the offering.[18]

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[16]Sanders v. Devine, Del. Ch., C.A. No. 14679, Lamb, V.C., Mem. Op. at 13 (Sept. 24, 1997) (emphasis added) (alleged omission in preferred stock prospectus cannot give rise to breach of fiduciary duty because plaintiff was not a stockholder at the time the prospectus was issued); accord Arnold v. Society for Savings Bancorp, Inc., Del. Ch., C.A. No. 12883, Chandler, V.C., Mem. Op. at 15-16 (June 15, 1995) (acquiring corporation owed no duty of disclosure to stockholders of acquired corporation, even though it participated in drafting proxy materials); accord Thorpe v. CERBCO, Inc., Del. Ch., C.A. No. 11713, Allen, C., Mem. Op. at 4-5 (Jan. 26, 1993) (plaintiffs could not challenge disclosure in proxy statement issued before they became stockholders); accord Zirn v. VLI Corp., Del. Ch., C.A. No. 9488, Hartnett, V.C., Mem. Op. at 12-13 (July 17, 1989) (tender offeror owed no fiduciary duty of disclosure to target corporation's stockholders); accord Glaser v. Norris, Del. Ch., C.A. No. 9538, Chandler, V.C., Slip Op. at 19-20 (July 13, 1989) (alleged omissions contained in prospectus cannot give rise to breach of fiduciary duty because prospective purchaser of stock not owed fiduciary duties).

[17]Del. Ch., C.A. No. 14679, Lamb, V.C., Mem. Op. (Sept. 24, 1997).

[18]Sanders at 13 (emphasis added).

In this case the alleged disclosure violation occurred in February, 1996. Because the plaintiff did not become a stockholder of Ventana until March 26, 1996, no fiduciary relationship or duty existed or arose at the time of the alleged violation.

The plaintiff argues that In re Cencom Cable Income Partners, L.P. Litig.[19] is authority to the contrary. I cannot agree. In Cencom, the general partner of a limited partnership retained a law firm to represent the interests of the limited partners, and disclosed the law firm's obligations to the limited partners. The Court held that in those circumstances, the general partner had "voluntarily assumed a duty to ensure that [the law firm] would fulfill these obligations and that the Limited Partners could rely on the General Partner's representation that [the law firm] would do so."[20] Cencom is distinguishable from this case and, moreover, does not support the proposition being advanced here. At issue in Cencom was whether the scope of the general partner's fiduciary duty to the limited partners -- persons to whom fiduciary duties were clearly owed -- extended beyond the duties expressly stated in the partnership agreement. Here, the plaintiff represents a class of investors to whom no fiduciary duties were owed at the time of the alleged disclosure violation.

Because the Director Defendants owed no fiduciary duty to the plaintiff class at the time their approval of the Merger was obtained, the "assumption of the fiduciary duty" claim in Count V must fail, and that Count of the complaint must be dismissed.[21]

III. THE DERIVATIVE CLAIMS

A. Introduction

[7-8] The remaining Counts of the complaint are derivative. The defendants seek the dismissal of those Counts under Rules 12(b)(6) and 23.1. Court of Chancery Rule 23.1 imposes special pleading requirements for derivative actions.[22] Those requirements are more stringent than the

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[19]Del. Ch., C.A. No. 14634, Steele, V.C., Mem. Op. (Oct. 15, 1997).

[20]Id. at 16.

[21]This does not mean that the plaintiff class has no available remedy. Although the Court finds that the complaint does not allege actionable disclosure claims under state law, the plaintiffs family has made the same conduct the subject of federal disclosure claims that are currently being pursued in the separate companion Federal action in the United States District Court for Delaware. The existence (or nonexistence) of disclosure liability under the Federal Securities laws is not dependent upon the existence of a fiduciary relationship.

[22]Rule 23.1 pertinently provides: "The complaint shall... allege with particularity the efforts, if any,... to obtain the action the plaintiff desires form the directors... and the reasons for the plaintiff's failure to obtain the action or for not making the effort."

notice pleading requirements governed by Court of Chancery Rule 8(a).[23] In cases where no demand is made, complaints in derivative actions must be pled with factual particularity. Although the plaintiff stockholder is not required to plead evidence, Rule 23.1 does require the plaintiff to plead particularized facts to excuse the failure to make a demand.[24]

The defendants argue that all three derivative Counts must be dismissed. First, the defendants argue that because the Insider Sale transaction concluded in January 1996 when the Ventana directors authorized the issuance of stock to the Insiders, and because the plaintiff did not become a shareholder until March 1996, the plaintiff lacks standing under Rule 23.1 and 8 Del. C. § 327 to assert a derivative claim challenging that stock issuance. Second, the defendants argue that the derivative counts must be dismissed because the plaintiff failed to make the pre-suit demand required by Rule 23.1 or to allege facts establishing that a demand would have been futile. Third, the defendants argue that even if the plaintiff has standing and a demand was excused, Counts II and III must be dismissed because they are based solely on a due care theory of liability, for which any monetary damage recovery is precluded by the exculpatory provision of Ventana's Articles of Incorporation.

In response, the plaintiff contends that he has standing to maintain the derivative Counts because the transaction complained of (the Insider Sale), was not completed until it was consummated in April and May of 1996, by which point the plaintiff was a Ventana shareholder. The plaintiff further argues that demand was excused, because (a) Count I alleges that the stock issuance was invalid per se and is not protected by the business judgment rule, (b) Count II alleges that the stock issuance constituted waste, and (c) Count III alleges that the directors acted in bad faith. Finally, the plaintiff contends that under 8 Del. C. § 102(b)(7), the Ventana exculpatory charter provision does not and cannot apply to claims of illegality, waste and bad faith.

These contentions raise three issues. The first involves standing, viz, when was the transaction complained of "complete" -- when the Insider Sale was authorized in January, 1996, or when the stock was issued in April and May of 1996? The second issue is whether a demand on the Ventana's board was excused on the basis that the Insider Sale was not a valid exercise of business judgment. The third issue is whether Counts I, II and III are barred by the exculpatory clause in Ventana's Articles of Incorporation.

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[23] Brehm v. Disney, Del. Supr., __ A.2d __, No. 469, 1998, Veasey, C.J. (Feb. 9, 2000).
[24] Aronson v. Lewis, Del. Supr., 473 A.2d 805, 814 (1984).

B. The Standing Defense

A threshold issue is whether the plaintiff was a shareholder at the time of the transaction complained of. If he was, then he has standing to bring the derivative claims. If he was not, then he lacks standing, and the derivative claims must be dismissed.

[9] Under 8 Del. C. § 327 and Rule 23.1, the critical time for determining standing is when the transaction complained of is completed.[25] The plaintiff argues that the transaction was not completed (and, hence, the claim did not arise) until the Ventana shares were issued to the Insiders in April and May, 1996, at which time the plaintiff was a Ventana stockholder. The plaintiff is correct. Maclary v. Pleasant Hills,[26] which is essentially on point, supports his position. In Maclary this Court held that the alleged wrongdoing -- the issuance of 100 shares of stock members of to the board of directors -- did not occur when the board authorized the issuance, but, rather, when the stock certificates were actually issued. The Court held that "[w]here certificates are presumably to be issued therefor at once, and that is the very action under attack, the transaction is not complete for purposes of applying 8 Del. C. § 327 until the certificates are issued."[27]

That same logic applies here. Although the Ventana directors may have authorized the issuance of stock to the Insiders in February, 1996, no claim could or did arise (because the transaction was not complete) until the shares were actually issued in April and May 1996. By that point the plaintiff was a stockholder. The plaintiff therefore has standing to assert the derivative claims.

The defendants argue that a recent decision, 7547 Partners v. Beck,[28] has overruled Maclary. I disagree. In Beck, the plaintiff challenged a board of directors' decision to sell stock to board members at a price lower than what was being offered to the public generally in the company's initial public offering ("IOP").[29] The Delaware Supreme Court held that the plaintiff lacked standing to raise derivative claims because the challenged conduct (setting the IPO price) predated the IPO in which the plaintiff purchased his shares,[30] for which reason the plaintiff was not a stockholder at the time of the conduct complained of.

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[25] 8 Del. C. § 327 relevantly provides:
"[i]t shall be averred in the complaint that the plaintiff was a stockholder of the corporation at the time of the transaction of which he complains or that his stock thereafter devolved upon him by operation of law."
[26] Del. Ch., 109 A.2d 830, 833-34 (1954).
[27] 109 A.2d at 834.
[28] Del. Supr., 682 A.2d 160 (1996).
[29] See id. at 162-63.
[30] See id. at 163.

[10] The claim advanced in Beck is different from the claims asserted here and in Maclary. In Beck, the alleged wrong was the board's decision to fix a below-market price for the stock being offered in the IPO. Once that price was fixed, the transaction was completed, and there was nothing further for the board to do. But, here (as in Maclary), the alleged wrong is the issuance of the stock to the Insiders in April and May 1996, rather than its authorization by the board two months before. Indeed, in this case, no claim for damage relief arose or could have arisen until the stock was actually issued.[31] Because the plaintiff was a stockholder at the time that took place, he has standing to assert Counts I through III.

C. The Demand Defense

[11] The next issue is whether the plaintiff was excused from making a demand on the Ventana board. Under Aronson v. Lewis[32] demand is considered futile, and will be deemed excused, if the particularized facts alleged in the complaint create a reasonable doubt that: (1) the directors are disinterested and independent, or (2) the challenged transaction was otherwise the product of a valid exercise of business judgment. Because the plaintiff does not challenge the independence and loyalty of the Defendant Directors, the analysis must focus on Aronson's second prong. That is, plaintiff's demand excusal argument is that the particularized factual allegations of the complaint create a reasonable doubt that the sale of Ventana stock to the Insiders at the $1.62 per share price was the product of a valid business judgment. The plaintiff contends that the complaint alleges cognizable claims, and excuses demand, for three reasons: (i) the Insider Sale was invalid per se, (ii) the Insider Sale was a waste of assets, and (iii) the Insider Sale was not approved in good faith. The defendants respond that none of these allegations states a cognizable claim for relief and must therefore be dismissed under Rule 12(b)(6), and under Rule 23.1 as well.

These arguments are next addressed.

1. The Illegal Stock Issuance Claim (Count I)

The defendants first argue that Count I must be dismissed under Rules 12(b)(6) and 23.1 because the complaint does not state a cognizable claim that the stock issuance to the Insiders was legally invalid. The plaintiff argues the contrary. He maintains that the Director Defendants' decision to

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[31]A claim for injunctive relief may have arisen at the time the insider Sale was authorized, but the claim asserted here is for post-issuance damages.

[32]Aronson v. Lewis, 473 A.2d at 814.

issue stock representing 26.5% of Ventana's equity in exchange for services that they did not value was invalid per se, and therefore cannot be defended as a proper exercise of the directors' business judgment. For that reason, plaintiff argues, the Insider Sale was not subject to the demand requirement.

[12-13] The Delaware General Corporation Law grants a board of directors considerable discretion in determining the consideration for the issuance of stock. 8 Del. C. § § 152 pertinently provides:

> "The consideration, . . ., for subscriptions to, or the purchase of, the capital stock to be issued by a corporation shall be paid in such form and in such manner as the board of directors shall determine. In the absence of actual fraud in the transaction, the judgment of the directors as to the value of such consideration shall be conclusive."[33]

8 Del. C. § 153 (a) provides, in part:

> "(a) Shares of stock with par value may be issued for such consideration, having a value not less than the par value thereof, as determined from time to time by the board of directors, or by the stockholders if the certificates of incorporation so provides."[34]

Thus, absent fraud, Sections 152 and 153 give a board considerable latitude in evaluating the kind and amount of consideration to be received for newly-issued stock.

The complaint here -- which does not claim fraud -- does allege the specific consideration being received for the to-be-issued stock, specifically, that the Insiders were being compensated with Ventana stock for the services they rendered, and would render, to Ventana, including their efforts in connection with "structuring and negotiating the Merger."

[14-15] The plaintiff argues under Delaware case law, a stock-for-services transaction is per se invalid if the services are not formally valued, because the statute imposes a duty upon the board to value the services. But the above-quoted statutory provisions do not so provide, nor do they explicitly require that the board conduct a "formal valuation." Nor do the cited cases support the per se invalidity proposition that plaintiff advances. Of course, a board must determine the value of services being received by the corporation in exchange for issuing the corporation's stock

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[33] 8 Del. C. § 152.
[34] 8 Del. C. § 153(a).

of equivalent value. But, the cited decisions do not hold that a board's failure to conduct a "formal" valuation of those services automatically vitiates the stock issuance as a matter of statutory law.[35] Rather, the board's duty to value services received in exchange for newly-issued stock is more properly understood as one aspect of its broader fiduciary duty of care. Moreover (and as discussed more fully infra in connection with the waste claim) the complaint alleges facts from which it may be inferred that the Ventana directors did determine the value of the services being rendered. Accordingly, to the extent Count I alleges that the stock issuance was invalid per se, that claim is unsupported in law. Moreover, because the complaint shows that the Insiders' services were valued (albeit not "formally)," the claim is unsupported by the pleaded facts. Accordingly, Count I must be dismissed because it fails to state a claim under Rule 12(b)(6) and does not excuse a demand on the board as required by Rule 23.1.

2. The Waste Claim (Count II)

[16] The defendants next argue that Count II must be dismissed under Rules 12(b)(6) and 23.1, for failure to state a cognizable claim that the Board's issuance of the shares to the Insiders constituted corporate waste. If a cognizable claim of waste is alleged, that would deprive the challenged conduct of the protection of the business judgment rule and, consequently, would excuse demand.

[17] The standard under Delaware law for pleading waste is stringent.[36] The plaintiff contends that the pleaded facts satisfy that stringent test. Here, it is alleged, the board issued shares representing approximately 26.5% of Ventana's post-issuance equity to the Insiders, but did not determine the

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[35]Bowen v. Imperial Theatres, Inc., Del. Ch., 115 A. 918, 920 (1922) (stock issuance held invalid when stock was issued to two members of the board where the authorization to issue the shares was not by the board of directors acting collectively, but, rather, was an individual decision by two of its members. The issue of valuation of services, was left undecided); John W. Cooney Co. v. Arlington Hotel Co., Del. Ch., 101 A. 879, 887-88 (1917), modified, Del. Supr., 106 A. 39 (1918) (Noting that because no money was paid for stock and there was "scanty opportunity" to perform work on behalf of the company, and no "statement as to the character or value" of the service rendered to the company, there must have been "an intention to avoid the statute and Constitution" requiring payment of adequate compensation for issuance of company stock.); Field v. Carlisle Corp., Del. Ch., 68 A.2d 817, 819-20 (1949) (holding that a Delaware corporation may not delegate its duty to comply with a provision of the articles of incorporation requiring "that the corporation's stock may be issued "for such consideration as may be fixed from time to time by the Board of Directors.")

[36]The Walt Disney Co. Derivative Litig., Del. Ch., 73 A.2d 342, 362 (1998) (to constitute waste "an exchange. . . [must be] so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration." aff'd Brehm v. Disney, Del. Supr., __ A.2d __, No. 469, 1998, Veasey, C. J. at 34 (Feb. 9, 2000) (quoting Glazer v. Zapata Corp., Del. Ch., 658 A.2d 176, 183 (1993)).

value of the services to be provided in exchange. That failure (it is claimed) is sufficient of itself to create a reasonable doubt that the Board committed waste, and it is amply sufficient when coupled with the allegation that the stock was issued to the Insiders at a fraction of market value. The claim that $1.62 was far less than market value rests on the alleged fact that the board valued the stock at $1.62 per share for purposes of the Insider Sale, but only 3 weeks later, the board mailed to BioTek Noteholders, solicitation materials that valued the Ventana Exchange Notes at $13.53 per share for purposes of converting the Notes into Ventana common shares. Plaintiff argues that issuing approximately 26.5% of Ventana's equity for only 12% of the price that the Noteholders would pay for the same stock when converting their Ventana Notes, constitutes cognizable waste sufficient to survive dismissal under Rule 12(b)(6) and to excuse demand under Rule 23.1.

Despite its surface appeal, the argument lacks merit. The standard for pleading waste has been described thusly:

> . . . [a] waste entails an exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade. Most often the claim is associated with a transfer of corporate assets that serves no corporate purpose; or for which no consideration at all is received. Such a transfer is in effect a gift. If, however, there is *any substantial* consideration received by the corporation, and if there is a *good faith judgment* that in the circumstances the transaction is worthwhile, there should be no finding of waste, even if the fact finder would conclude *ex post* that the transaction was unreasonably risky. Any other rule would deter corporate boards from the optimal rational acceptance of risk, for reasons explained elsewhere. Courts are ill-fitted to attempt to weigh the "adequacy" of consideration under the waste standard or, *ex-post*, to judge appropriate degrees of business risk.[37]

[18] Thus, even if the complaint alleges facts that if true would show that in hindsight the consideration was inadequate, that alone will not satisfy the waste standard. The particularized pleaded facts must show that the

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[37]Vogelstein, 699 A.2d at 336 (emphasis added) (citations omitted); accord, Grimes, 673A.2d at 12, 14. Consistent with this view, the Delaware Supreme Court, has recently found that a complaint challenging an agreement that called for a $140 million severance payment to a senior executive did not allege waste, and noting that waste claims are "confined to unconscionable cases where directors irrationally squander or give away corporate assets." Brehm v. Disney, Del. Supr., ___ A.2d ___, No. 469, 1998, Veasey, C. J. (Feb. 9, 2000) Slip Op. at __.

consideration received for the stock was so minimal that issuing the Ventana stock was the functional equivalent of making a gift to the Insiders. Although the issued stock constituted one fourth of Ventana's outstanding common shares, the complaint does not allege that the Defendant Directors irrationally gave away those shares for essentially no consideration. To the contrary, the pleaded facts show that the board knew the precise value of the stock to be issued as compensation, and the nature of the services being rendered in exchange therefor.[38] Inherent in the act of setting the number of to-be-issued shares (646,734) and the price per share ($1.62) was the board's determination that the value of the services being performed was commensurate with the aggregate value of the shares being sold. Given those pleaded facts, I am unable to conclude that a claim of waste has been stated that would survive dismissal under Rule 12(b)(6), or that would excuse a demand under Rule 23.1. For these reasons, Count II will be dismissed.

3. The "Bad Faith" Claim (Count III)

Lastly, the defendants argue that the motions to dismiss should be denied because the complaint does not allege a cognizable claim that the Director Defendants' approval of the Insider Sale was made in good faith. The basis for this claim is that the Director Defendants (i) failed to value Patience and Schuler's services before authorizing the issuance of the shares; (ii) determined a fair market value of Ventana common stock that was significantly less than the conversion price offered to the former BioTek stockholders only weeks later, and (3) included conditions in the Memorandum that "implicitly acknowledged" a "lack of confidence" that the Board had priced the Insider Sale at fair market value.[39]

[19-20] Under the business judgment rule a board's good faith in making a decision is presumed. That presumption is heightened where, as here, the majority of the directors making the decision are independent or outside directors.[40] To overcome that presumption and to survive a motion to dismiss under Rule 12(b) (6) or Rule 23.1, the complaint must plead specific facts from which it can be inferred that "the decision [by the board] is so beyond the bounds of reasonable judgment that it seems essentially

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[38]The Memorandum describes the services that the Insiders would be performing. Those services are also summarized in the July, 1996 Preliminary Prospectus furnished in connection with the Ventana IPO.

[39]Complaint at ¶39.

[40]Moran v. Household Int'l. Inc., Del. Ch., 490 A.2d 1059, 1074-75 (1985); aff'd, Del. Supr., 500 A.2d 1346 (1985); Solash v. Telex Corp., Del. Ch., C.A. Nos. 9518 & 9528, Allen, C., Mem. Op. at 8 (Jan. 19, 1988).

inexplicable on any other grounds."[41] The complaint here falls short of meeting that standard.

First, as previously discussed, the claim that the Defendant Directors failed to value the services of Patience and Schuler before approving the issuance of the stock is unsupported. While it may be true that no formal valuation was conducted, the pleaded facts show that the board knew the value of the compensation (in the form of stock) it was awarding to the Insiders and the nature of the services the Insiders would perform in exchange. Moreover, the complaint alleges that a fair market evaluation of the Ventana common stock did take place, the valuation being $1.62 per share.

Second, the fact that the $13.53 per share conversion price offered to the BioTek noteholders was greater than the $1.62 per share fair market value of the shares sold to the Insiders, does not, without more, defeat the presumption that the Ventana board acted in good faith. Nowhere is it alleged that any BioTek noteholder was told that the $13.53 conversion rate being offered in the Merger was the fair market value of the Ventana stock, nor is it fair to infer that equivalence. The inference that is fair and reasonable, is that the conversion price offered to the BioTek noteholders was equal to the amount and value of the equity Ventana was willing to pay for BioTek. To put it differently, the Ventana board, in exercising its business judgment, did not believe that the $1.62 per share fair market value of Ventana stock was a conversion rate that Ventana should pay to the BioTek noteholders in order to purchase BioTek. Had the BioTek noteholders been given a conversion price in the Merger equal to $1.62 per share, that would result in Ventana transferring almost half of its equity to BioTek's noteholders in exchange for a financially troubled company.[42]

Finally, the fact that the Memorandum provided for contingency safeguards in the event the SEC disagreed with the fair market valuation of Ventana's common stock, does not evidence that the board acted in bad faith. What that contingency does indicate is that determining the fair market value

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[41]In re Rexene Corp. Shareholder Litig., Del. Ch., C.A. Nos. 10897 & 11300, Mem. Op. at 8, Berger, V.C. (May 8, 1991); aff'd sub nom. Eichorn v. Rexene Corp. Del. Supr., 604 A.2d 416 (1991) (TABLE); see also Solash at 22-23 (to infer bad faith the board's decision must be "so grossly off the mark as to amount to 'reckless indifference' or 'gross abuse of discretion'").

[42]The financial difficulties of BioTek were disclosed in the Information Statement formulated to the BioTek noteholders and Ventana preferred stockholders. The Information Statement, which is incorporated into the complaint by reference, states that "... It has been the goal of BioTek directors, in this process, to seek to satisfy, to the extent possible, the claims of creditors of BioTek... [T]he benefit of the Merger to BioTek is the ability of BioTek to achieve an orderly resolution of creditor claims..." Information Statement at 10. That document may be considered on a motion to dismiss for purposes of determining what facts were disclosed to BioTek noteholders, and accordingly, what facts the Ventana directors knew at the time of the Merger.

of the common stock of a non-publicly held company is a matter of judgment about reasonable persons can disagree. In this case the "SEC disapproval" condition was designed to protect the corporation: if the SEC disagreed with the board's fair market value determination, the Insider Sale would not go forward at the price contemplated. That the board recognized and provided for that risk may evidence its conservatism, but that is hardly emblematic of bad faith.

I conclude, for these reasons that the complaint fails to state a cognizable claim, under either Rule 12(b) (6) or Rule 23.1, that in approving the Sale to the Insiders the Ventana board acted in bad faith and breached its duty of loyalty. Count V must therefore be dismissed.

C. The Effect of the Exculpatory Clause

[21] Lastly, the defendants argue that the derivative claims sound in gross negligence. Even if that is so, the claims would fail as against the Director Defendants, because any duty of care claims for monetary damages are precluded by Article XI of Ventana's Amended and Restated Certificate of Incorporation, which is modeled after 8 Del. C. § 102(b)(7).[43]

Because Counts I through III will be dismissed on Rule 12 (b)(6) and Rule 23.1 grounds, there is no need to decide whether Ventana's Certificate provision exculpates its directors from liability for money damages with respect to those Counts.

IV. CONCLUSION

For the above reasons, the motions to dismiss the class claims under Rule 12(b)(6), and to dismiss the derivative claims under Rule 12(b)(6) and Rule 23.1, will be granted. Counsel shall submit an appropriate form of order implementing the rulings made in this Opinion.

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[43]Article XI of the Amended and Restated Certificate of Incorporation pertinently states that: "[A] director of the [C]orporation shall not be personally liable to the Corporation or its stockholders for monetary damages for breach of fiduciary duty as a director."

IN RE MARRIOTT HOTEL PROPERTIES II LIMITED PARTNERSHIP UNITHOLDERS LITIGATION

No. 14,961 (Consolidated)

Court of Chancery of the State of Delaware, New Castle

January 24, 2000

Plaintiff filed several claims challenging defendants' general partner and its parent corporation's tender offer for plaintiff's limited partner holdings. Plaintiff alleged this transaction was invalid due to lack of disclosure, breach of contract, and coercion claims. Plaintiff also argues that the tender offer should be treated as a merger, subjecting the defendants to a duty of entire fairness.

The court of chancery, per Vice Chancellor Lamb, held that the challenged transaction was a tender offer and not a merger, precluding application of the entire fairness standard. The court dismissed that plaintiff's contract claims, coercion claims, and disclosure claims not relating to distributions, but found that further discovery was necessary on plaintiff's breach of the duty of loyalty claim and that plaintiff's disclosure claims relating to projected distributions would survive the motion to dismiss. Defendants' motion to dismiss was therefore granted in part and denied in part. The defendants' motion for summary judgment was denied.

1. Federal Civil Procedure ☞ 1721
   Pretrial Procedure ☞ 626, 679, 683

For the purposes of the motion to dismiss, the court takes as true all well-pleaded allegations in the complaint and draws any reasonable inferences therefrom in plaintiff's favor; however, conclusions will not be accepted as true without specific allegations of fact to support them.

2. Pretrial Procedure ☞ 679, 683

The motion to dismiss will be denied unless it appears with reasonable certainty that plaintiff could not prevail on any set of facts that can be inferred from the pleading.

3. Federal Civil Procedure ⚷ 2461, 2464, 2470
Judgment ⚷ 181(1), 181(5.1)

A motion for summary judgment will be granted when no genuine issue as to material fact exists and the moving party is entitled to judgment as a matter of law. DEL. CH. CT. R. 56(c).

4. Federal Civil Procedure ⚷ 2461, 2470
Judgment ⚷ 181(1), 181(5.1)

The moving party in a motion for summary judgment has the burden of clearly proving that no material factual dispute exists and the court resolves any doubt against the moving party.

5. Federal Civil Procedure ⚷ 2461, 2464, 2470.4
Judgment ⚷ 181(1), 181(3), 181(5.1)

If a more thorough development of the record would clarify the law or its application, the court may, in its discretion, deny summary judgment.

6. Partnership ⚷ 70, 370, 375

To the extent that the complaint states a disclosure claim and plaintiff was thereby not fully informed about the nature of his claim when he tendered his shares, he did not acquiesce in defendants' alleged misconduct.

7. Partnership ⚷ 70, 95, 366

The entire fairness standard applies in the case of a merger, but not in the case of a tender offer.

8. Partnership ⚷ 70, 76, 95, 366

In extending an offer to the limited partners to buy their limited partnership units, the general partner owes a duty of full disclosure of material information respecting the business and value of the partnership which is in its possession.

9. Corporations ⚷ 197, 307

An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote;

*the standard does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote, but the standard does contemplate a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder.

10. Partnership ⚿ 70, 92, 366

When the lone source of disclosure is a fiduciary having a conflicting interest, an obligation of complete candor is imposed on the fiduciary and judicial scrutiny of the disclosure is more exacting.

11. Partnership ⚿ 70, 76, 77, 92, 366

If limited partners can prove that the general partner limited distributions in anticipation of the offer, that decision could be viewed as an interested transaction subject to heightened judicial scrutiny. DEL. CODE ANN. tit. 8, § 144 (1990).

12. Partnership ⚿ 70, 95, 366

There is a fundamental difference between a merger, in which the general partner (or, in the corporation context, the board of directors) plays an integral role, and a tender offer, in which the offeror deals directly with the limited partners (or stockholders) and the tender offer is not subject to an entire fairness standard.

13. Corporations ⚿ 307, 310(1)
Partnership ⚿ 70, 92, 366

Where one party stands on both sides of a transaction, the entire fairness test properly applies to protect minority stockholders from the tyranny of the controlling entity.

14. Partnership ⚿ 349, 366

The Delaware Revised Uniform Limited Partnership Act's statement that a partner has no interest in specific limited partnership property has been interpreted to preclude the attempt to equate ownership interests in a partnership with ownership of partnership property. DEL. CODE ANN. tit. 6, § 17-701 (1990).

15. Contracts ⚷ 143(1), 147(1), 168

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

16. Contracts ⚷ 143(1), 147(1), 168

It is not the proper role of a court to rewrite or supply omitted provisions to a written agreement, where the situation is not factually unusual enough to make it appropriate for a court to, based on the surrounding circumstances, draw from and enforce implied obligations in a contract.

17. Corporations ⚷ 307
Partnership ⚷ 70, 95, 366

Unlike a third party tender offeror, who is subject to no fiduciary duties to target-company stockholders, when a general partner (or one of its affiliates) of the target company is the offeror, the offeror is unquestionably subject to the requirement of Delaware law that its offer be made with complete disclosure and be non-coercive.

18. Corporations ⚷ 182.4, 307
Partnership ⚷ 70, 95, 366
Pleading ⚷ 48

The adequacy of the price in a tender offer does not raise a triable issue unless price is connected to valid claims of breach of fiduciary duty, such as disclosure problems or actionable coercion.

19. Corporations ⚷ 182.4
Partnership ⚷ 70, 95, 366

The legal premise behind the law's treatment of a tender offer is the understanding that tender offers are voluntary transactions.

20. Corporations ☞ 182.4, 307
Partnership ☞ 70, 95, 366

Tender offers for majority control regularly occur and have never been found coercive for that reason alone.

21. Partnership ☞ 70, 95, 366

Adverse tax implications to nontendering unitholders do not constitute a reason why a fiduciary cannot extend an any-and-all offer; otherwise the availability of potentially valuable transactions would be sharply reduced.

22. Corporations ☞ 182.4, 307, 310(1)
Partnership ☞ 70, 95, 366

Accurate descriptions of the consequences of a successful tender offer do not amount to coercion.

23. Partnership ☞ 70, 76, 366

Disagreement between parties with respect to the valuation methodology used is not an adequate reason for finding a disclosure violation.

24. Corporations ☞ 320(1), 320(4)
Partnership ☞ 70, 95, 366

A person who voluntarily accepts the benefits of a transaction with knowledge or means of knowledge of all the material circumstances thereof is precluded from thereafter attacking the same transaction; the crux of the issue is whether the party was informed when accepting the benefits.

Norman M. Monhait, Esquire, of Rosenthal, Monhait, Gross & Goddess, P.A., Wilmington, Delaware; and Lawrence P. Kolker, Esquire, of Wolf Haldenstein Adler Freeman & Herz, LLP, New York, New York, of counsel, for plaintiffs.

Lawrence C. Ashby, Esquire, of Ashby & Geddes, Wilimington, Delaware; and Joseph M. Hasset, Esquire, of Hogan & Hartson, L.L.P., Washington, D.C., of counsel, for defendants.

LAMB, *Vice Chancellor*

I. INTRODUCTION

This matter arises out of a 1996 tender offer to purchase the limited partnership interests of Marriott Hotel Properties II Limited Partnership (the "Partnership"). The corporate parent of the Partnership's general partner was the offeror. When the tender offer initially failed to attract sufficient tenders, the offeror raised the offering price by 25% and succeeded in acquiring slightly more than a majority stake in the Partnership. Within months of closing the tender offer, the general partner, in a change from its prior distribution policy and the projections forecast in the tender offer circular, more than doubled the size of its cash distributions to limited partners.

This and related cases were consolidated by court order, and are the subject of two prior opinions of this court. In the first, former Chancellor Allen denied a motion for preliminary injunctive relief.[1] In the second, I granted a voluntary dismissal, permitting the refiling of the complaint in the United States District Court for the Southern District of Florida, where a nearly identical complaint had already survived a motion to dismiss and was scheduled for trial.[2] After some defection in plaintiffs' ranks, however, the District Court dismissed the action for want of subject matter jurisdiction. I later granted leave to revive the dismissed action here. An amended class action complaint was filed on January 29, 1999 by Cary W. Salter, the sole remaining representative plaintiff.

The amended complaint alleges, among other things, that the defendants were under a duty to pay a fair price to the limited partners for their Partnership units. Plaintiff argues first that the tender offer should be treated as a merger, subjecting the defendants, as controlling entities, to a duty of entire fairness. Alternatively, plaintiff argues that the partnership agreement creates either an express or implied right to a fair valuation process. Finally, plaintiff contends that he and his fellow limited partners were coerced into tendering or were inadequately informed when they did so.

Defendants filed a motion to dismiss, and with respect to one claim, a motion for summary judgment. Having reviewed the record on the motions, I conclude that the complaint states disclosure claims relating to projected future distributions. Also, additional discovery is warranted to determine whether the general partner suppressed the level of distributions (and, with it, the value of the partnership units) until after the parent could close its offer.

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[1] *See In re Marriott Hotel Properties II L.P. Unitholders Litig.*, Del. Ch., C.A. No. 14961, Allen, C. (June 12, 1996) ("PI Opinion").

[2] *See In re Marriott Hotel Properties II L. P. Unitholders Litig.*, Del. Ch., C.A. No. 14961, Lamb, V.C. (Sept. 17, 1997) ("Dismissal Opinion").

II. FACTUAL HISTORY

For the purposes of the motion to dismiss,[3] I take as true all well-pleaded facts in the complaint and draw any reasonable inferences therefrom in plaintiff's favor.[4] Moreover, to the extent necessary, I have examined the disclosure documents disseminated in connection with the transactions at issue in order to determine what was actually disclosed. This practice is, in the circumstances, permissible and necessary.[5]

A. The Parties

When this putative class action began, there were three representative plaintiff limited partners, Cary W. Salter, Mackenzie Patterson Special Fund 2, L.P. (" Mackenzie Fund") and George Wasserman. As of the filing of the "Amended Consolidated Class Action Complaint" on January 29, 1999, Salter is the only remaining representative plaintiff.

Defendants are: the general partner - Marriott MHP Two Corporation (" General Partner"), its parent - Host Marriott Corporation ("Host" or "Host Marriott"), an entity wholly-owned by Host and formed for the purpose of carrying out the tender offer - MHP II Acquisition Corporation, and four individuals sued in their capacities as the directors and principal executive officers of the General Partner.

B. The Formation of the Partnership

The Partnership was formed in 1988 to acquire, own and operate three hotels in the United States and to have a 50% interest in a fourth. A total of 745 limited partnership units ("Units") were sold for a stated price of $100,000 each (or $89,247, if paid in cash at the time of subscription). As disclosed in the private placement memorandum ("PPM"), pursuant to which the Units were sold, the hotels were subject to long-term management agreements with Marriott Hotels, Inc., at the time a wholly-owned subsidiary of Marriott Corporation.[6]

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[3] Facts relating to the motion for summary judgment are addressed separately at part III.D.2 of this Opinion.

[4] *See In re Tri-Star Pictures, Inc., Litig.*, Del. Supr., 634 A.2d 319, 326 (1993).

[5] *In re Santa Fe Pac. Corp. Shareholder Litig.*, Del. Supr., 669 A.2d 59, 68-69 (1995).

[6] In October 1993, Marriott Corporation divided into two publicly traded corporations, Host Marriott, a defendant in this action, and Marriott International, Inc. ("Marriott International"). Host Marriott continued the business of owning lodging properties, and the General Partner became its wholly-owned subsidiary. Marriott International continued the business of lodging and senior living services management, and as such, became the manager of the Partnership's properties. Any further reference in this opinion to the manager is to Marriott International.

C. The Limited Partners' Rights Were Narrow

The terms of the partnership agreement placed the General Partner firmly in control of the affairs of the Partnership. Four of its provisions illustrate the point.

- Marriott MHP is named as the General Partner and can be removed by the limited partners only in narrowly defined circumstances amounting to cause.

- The General Partner is given "the exclusive right and power to conduct the business and affairs of the Partnership and to do all things necessary to carry on the business of the Partnership in accordance with the provisions of this Agreement and applicable law . . . ."

- The voting rights of the limited partners are restricted to extraordinary transactions, such as the sale of the Partnership's assets, a merger or a dissolution.

- Although the limited partners have the right to assign their entire economic interest in the partnership without the General Partner's consent, the General Partner has the right to decide, in its "absolute discretion," whether or not to admit an assignee of a limited partner's interest as a substituted limited partner. A limited partner's right to vote terminates upon the assignment of his interest, and only by becoming a substituted limited partner does the assignee of that interest become entitled to vote.

The limited partners' restricted power either to assign the voting right or to replace the General Partner significantly curtailed their ability, even acting collectively, to exercise control over the Partnership or to transfer control thereof to any other person. This is hardly surprising in the context of an investment formed for the purpose of acquiring interests in four hotel properties managed by Marriott.[7]

While the limited partners could not exercise direct control over the Partnership or profit by selling such control to a third party not endorsed by

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[7]The intention to maintain control with Marriott was disclosed to the Unitholders in the PPM, which stated: "It is not anticipated that any public market will exist for the Units, and the Partnership Agreement imposes certain restrictions on transfer designed to ensure that one will not develop."

the General Partner, an investment in the Partnership Units offered significant economic benefits. For investors, the Partnership's "principal investment objectives" were "(i) to provide semi-annual cash distributions from operations of [its] Hotels . . .; (ii) to benefit from potential long-term appreciation . . . ; and (iii) to preserve investor capital . . . ."[8] There was also the possibility of a significant distribution of excess funds obtained in a refinancing of over $250 million in outstanding mortgage debt (the "Refinancing"). The partnership agreement required that all "Cash Available for Distribution . . . shall be distributed at least semi-annually . . . ."[9] However, the General Partner could reduce the amount to be distributed as it "reasonably determines [is] necessary to provide for the . . . operation of the Partnership."[10]

As initially structured, Host Marriott, directly and indirectly, had only a *de minimis* interest in the partnership equity. Therefore, in contrast with the limited partners' expectation of distributions as a source of income, Host Marriott derived its economic benefits through the management agreements.

The partnership agreement affirms the fiduciary duty owed by the General Partner to the Partnership and the limited partners, arising from 6 *Del. C.* § 17-403 and the common law. Section 5.03(I) of that agreement provides:

> The General Partner shall be under a duty to conduct the affairs of the Partnership in good faith and in accordance with the terms of this Agreement . . . . Nothing contained in the Agreement is intended or shall be construed to contract away the fiduciary duty of the General Partner to the limited partners.[11]

Further, provisions of the partnership agreement recognize that, in dealing with Host Marriott or its affiliates, the General Partner would have a conflict of interest. For example, section 5.02(B)(ii) of the partnership agreement provided for an independent appraisal process to value the hotels in the case of a sale of one or more hotels to Host Marriott.

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[8]PPM at 4.

[9]Partnership Agreement § 4.06(A). The partnership agreement excludes from "Cash Available for Distribution" any "reserves as may be determined by the General Partner, in its reasonable discretion, to be necessary to provide for the foreseeable needs of the Partnership, including, without limitation, for the maintenance, repair or restoration of the Hotels." *Id.* § 1.01.

[10]Partnership Agreement § 4.06(13).

[11]This clause is important because, in contrast with other limited partnership agreements that contractually limit the fiduciary obligations of the general partner, *see, e.g., Sonet v. Timber Co., L.P.*, Del. Ch., 722 A.2d 319 (1998), the agreement at issue makes clear that the General Partner's fiduciary duties would *not* be limited by contract.

The agreement does not explicitly address the circumstance of Host making a tender offer to acquire Units. In fact, as originally framed, the agreement denied Host Marriott the right to vote any limited partnership interests, even those purchased by it from a limited partner. As discussed, *infra*, the limited partners voted to amend this provision in connection with the transaction at issue.

D. The Partnership Is Successful

Hotel operating profit exceeded projections, allowing the General Partner to make annual cash distributions to Unitholders in excess of those projected at the time of formation. Through 1995, the Partnership distributed nearly $97,000 per Unit versus a projected $69,000. The complaint also alleges that the Partnership's cash on hand increased dramatically. By 1995, the Partnership had $46,961,000 of cash on hand,[12] a $14 million increase from the prior year.

The complaint alleges that the "increases in hotel operating profit and growth in value of the Partnership's properties . . . did not benefit the limited partners because the General Partner did not increase distributions to Unitholders." Instead, the complaint alleges, "annual distributions were frozen at $15,000 per Unit in 1993, 1994 and 1995," thus distorting the limited partners' perception of Unit value.

The mortgage debt on the hotels was due to mature on March 21, 1996. Rather than complete a refinancing, the General Partner arranged a six-month extension to September 21, 1996. In connection with the extension, the Partnership applied $9.2 million of the amount accumulated in a lender reserve account to pay down principal. Moreover, the Partnership added $19.1 million of other cash to that reserve. Plaintiff alleges that the General Partner failed to timely refinance the mortgages on the Partnership's hotels before Host Marriott made its tender offer in order to coerce limited partners into tendering.

E. The Tender Offer

On April 18, 1996, Host began a tender offer for any and all of the outstanding Units at a price of $125,000 per Unit, conditioned on obtaining at least 50.1% of the outstanding Units (the "Offer").[13] The General Partner,

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[12]According to plaintiffs, this amount consisted of: $7.725 million due from Marriott International, Inc., $11.940 million in a "property improvement fund," $9.193 million in a restricted cash reserve, and $21.601 million in cash and cash equivalents, less total liabilities of $3.048 million.

[13]The Offer was also conditioned upon approval of the proposed amendments to the

due to its "substantial conflicts of interest with respect to the Offer" made "no recommendation to any Unitholder whether to tender or to refrain from tendering his or her Unit." Rather, the limited partners were urged to make up their own minds about the merits of the tender offer. The tender offer circular ("Offer to Purchase") reported that:

- "Parent [Host Marriott] has at all times had the ability to control . . . General Partner."
- "No unaffiliated person has been retained to represent the limited partners and to act solely on their behalf to negotiate or evaluate the Offer. If an unaffiliated person had been engaged, the terms and conditions of the Offer might have been different, and possibly more favorable to Unitholders who elect to tender their Unit."
- "The Offer Price (as well as the other terms and conditions of the Offer) was established by Host Marriott, which is the indirect parent of the General Partner, and is not the result of arm's length negotiations."
- "Parent believes that the Partnership's properties have increased in value over the last several years and, although there can be no assurances, may continue to appreciate in value."
- "The Purchaser and Parent are making the Offer with a view to making a profit."

F. The Amendments to the Partnership Agreement

Host Marriott conditioned the Offer on the approval by the limited partners of certain amendments to the partnership agreement (the "Amendments"). Most significantly, Host sought changes in the partnership agreement to permit affiliates of the General Partner (such as the acquirer) to vote Units acquired and to remove the prohibition against the transfer of more than 50% of the partnership Units within a 12-month period (the "Consent Solicitation").[14] The General Partner disseminated disclosure

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partnership agreement, discussed in section II. F, *infra*.

[14]Other, minor changes were made in the partnership agreement. For instance, in light

materials to the limited partners, asking the limited partners to consider and vote upon the Amendments, but making no recommendation.

Plaintiff complains that "the defendants chose to use their Tender Offer as an opportunity to coerce the limited partners into approving five unfair Amendments by delaying the solicitation until the commencement of the Tender Offer, and then making the approval of all five Amendments a condition for completing the Tender Offer." In fact, while the Offer was conditioned upon the successful completion of the Consent Solicitation, the two were conducted separately; thus, a Unitholder was able to make a valid tender without consenting to the Amendments and was able to consent to the Amendments without tendering.

The Amendments were approved by the limited partners and became effective in conjunction with the successful completion of the Offer.

G. The Offer to Purchase Makes Certain Projections and Disclosures

Plaintiff challenges various elements of the disclosure provided by Host Marriott and the General Partner in the Offer to Purchase.

First, the Offer to Purchase disclosed that Host Marriott engaged American Appraisal Associates ("American") for the purpose of obtaining a fairness opinion on the financial terms and conditions of the Offer. American's analysis, appended to the Offer to Purchase, concluded that $125,000 was fair to the Unitholders from a financial point of view because the estimated value of the Units ranged from a low of $65,000 per Unit to a maximum of $146,000 per Unit, with a mid-point of $104,000 per Unit.

Plaintiff alleges that the appraisal results were manipulated to reduce the stated value of the hotels and the Units. Plaintiff alleges that the value of the hotels had more than doubled by the time of the Offer. (The fact that the Partnership was valued at $237,334 per Unit in 1998, as discussed *infra*, leads to a dispute about whether the gains in value can fairly be attributed to events arising *after* the Offer closed.)

Second, plaintiff challenges the description of the Partnership's cash reserves. The "Net Asset (Break Up) Analysis," which was based on appraisals of the hotels and the "[c]ash and cash equivalents that were added to calculate the net value to Unitholders," is alleged to exclude cash available at "break up" of approximately $71,000 per Unit. According to plaintiff, the

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of the earlier separation of Host Marriott and Marriott International, Inc., the definition of "affiliate" found in that agreement was amended to exclude publicly traded entities unless there is a common 20% ownership of the General Partner and such other person by the same person or group. Paragraph 41 of the complaint lumps these amendments to the agreement together and, without explanation or analysis, labels them all "unfair."

cash value available through break up is patently inconsistent with a valuation of $104,000 per Unit. By misrepresenting the value of the Partnership's cash and cash equivalents, Host allegedly induced the limited partners to tender their shares for a lower price man they would have had the amount of available cash been disclosed properly.

Third, the Offer to Purchase projected 1996 distributions of $11,612 per Unit and 1997 distributions of $16,880 per Unit.[15] These predictions were coupled with statements indicating that debt service requirements "could adversely affect cash distributions from the Partnership."[16] Plaintiff argues that the projections of future distributions were false and misleading when made, because the defendants knew when making those projections that distributions would increase once the Offer closed.

Fourth, plaintiff attacks the disclosure related to Host's motivations in making the Offer. According to plaintiff, the Offer to Purchase failed to disclose that Host expected to benefit by virtue of increased cash distributions in the future and by including the Partnership's assets on Host's balance sheet.

Finally, the Complaint claims that the disclosures made by Host Marriott in the Offer to Purchase about the prospects and expected terms of the delayed refinancing coerced Unitholders to tender. The pertinent language from the Offer to Purchase describes the prospects for future financing as follows:

> The General Partner has informed Host Marriott that it is exploring various options to refinance at least the current $257 million of mortgage debt . . . [and] believes that . . . a [commercial mortgage-backed securities] financing would offer more favorable long-term interest rates than bank financing and would afford Unitholders a better opportunity to continue to receive cash distributions. The securitized financing the General Partner is currently considering would likely have a term of approximately 10-11 years, substantially restrict the ability of the Partnership to sell [its properties] during the term and prohibit the Partnership from prepaying any debt during the term without paying a substantial premium. In addition, the interest rate would likely be fixed for the entire term at a spread of 1.50% to 1.60% over the yield

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[15]Offer to Purchase at 19. The ten-year projections were as follows: $11,612 in 1996, $16,880 in 1997, $17,764 in 1998, $18,202 in 1999, $19,358 in 2000, $20,807 in 2001, $22,497 in 2002, $24,247 in 2003, $26,055 in 2004 and $27,929 in 2005.

[16]Offer to Purchase at 8.

> of the U.S. Treasury Note with the same maturity as the term of the debt.[17]

The Offer to Purchase described the steps taken in furtherance of the expected refinancing and opined as to the availability of funds after the refinancing, as follows:

> [I]n connection with the contemplated refinancing of the mortgage debt of the [properties], the General Partner may use the funds in reserve accounts established by the Partnership for the costs and expenses associated with the refinancing, to pay down principal, to establish escrow accounts (if required) or for distribution to Unitholders. At March 31, 1996 there was approximately $19.1 million (approximately $25,381 per Unit) in the primary reserve account. In addition, if the Partnership's outstanding mortgage debt were refinanced at its previous level of $266 million, there would be approximately $9.2 million in excess proceeds (approximately $12,226 per Unit) available to the Partnership. Based upon the current market for refinancing, [defendants] believe that a significant portion of the current reserve accounts will be needed to (i) establish escrow accounts or reserves, (ii) pay the costs and expenses of refinancing, and/or (iii) pay down debt.[18]

Plaintiff contends that the defendants misrepresented the Partnership's ability to make a distribution of excess funds from a refinancing. Partly because the PPM had discussed this option as a possible course of action as early as 1993, plaintiff alleges that the failure to describe a large refinancing distribution as a realistic alternative led limited partners to conclude that the only way to enjoy a sizeable return of their capital in the near future would be to tender into the Offer.

H. The Motion for a Preliminary Injunction Fails

On May 17, 1996, the plaintiffs moved for a preliminary injunction against consummation of the Offer. Plaintiffs made two separate but related claims. They argued first that the price was inadequate because it should have included a control premium and, second, that defendants had a duty to

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[17] *Id.*
[18] *Id.*

ensure that the limited partners received a fair price, either as a matter of law or as a consequence of certain provisions of the partnership agreement.

Chancellor Allen denied the motion, holding, on a preliminary basis, that the structural elements of the Partnership giving Host Marriott effective control over the management and disposition of the assets of the Partnership precluded a finding that the limited partners were entitled to any premium for the passage of "control." In particular, he noted the provisions of the partnership agreement giving the General Partner "absolute discretion" over the admission of persons as substituted limited partners and the legal consequence of that provision.[19] Thus, he found that the "absolute discretion" enjoyed by the General Partner under the partnership agreement was entirely inconsistent with the existence of a fiduciary duty to locate or approve a sale at a higher price to a third party.[20]

Chancellor Allen also grounded his denial of the preliminary injunction motion on the well-established precedent that Host was under no fiduciary duty to offer a "fair" price for the limited partnership interests, so long as the tender offer did not entail coercion and was made with full disclosure.[21] As Chancellor Marvel explained, "it would not be appropriate under equitable principles . . . to bind an offeror [making a noncoercive tender offer on full information] to an implied commitment to pay additional consideration for tendered shares in an amount made up of the difference between the price offered and what might ultimately be found to be the intrinsic value of the shares in question.[22] Reaching a preliminary conclusion that the Offer was not structurally coercive and that disclosures were not defective, Chancellor Allen denied the motion.[23]

Although Chancellor Allen perceived no justification to enjoin the Offer, his final remark was that "[t]he theories of plaintiffs that the general

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[19]*See PI Opinion* at 10-11 (stating that express provisions of detailed limited partnership agreements concerning the rights and duties of the parties thereto, and not broad concepts of fiduciary duties, will "form the metric for determining breach of duty" (citing *In Re Cencom Cable Income Partners, L.P. Litig.*, Del. Ch., C.A. No. 14634, Steele, V.C. (Feb. 15, 1996))).

[20]*PI Opinion* at 13-16. This conclusion is consistent with and, indeed, compelled by applicable Delaware precedent. *See generally Mendel v. Carroll*, Del. Ch., 651 A.2d 297 (1994) (noting legal recognition of validity of "control premium" rooted in reality that blocks of securities that carry corporate control are more highly valued by market); *Paramount Communications, Inc. v. Time Inc.*, Del. Supr., 571 A.2d 1140 (1989) (finding no duty to maximize present value of shares in transaction because no change of corporate control); *Paramount Communications Inc. v. QVC Network, Inc.*, Del. Supr., 637 A.2d 34, 48 (1993) (finding directors' obligation to seek the best value reasonably available to the stockholders required only in case of change of control transaction).

[21]*PI Opinion* at 12. *See Lynch v. Vickers Energy Corp.*, Del. Ch., 351 A.2d 570, 576 (1976); *rev'd on other grounds*, Del. Supr., 383 A.2d 278 (1977); *Solomon v. Pathe Communications Corp.*, Del. Supr., 672 A.2d 35, 39 (1996) ("In the case of totally voluntary tender offers . . . courts do not impose any right of the shareholders to receive a particular price.").

[22]351 A.2d at 576.

[23]*PI Opinion* at 23.

partner has intentionally arranged matters (*i.e.*, the recent opportunity to refinance) in a way to push limited partners to sell, and that, in the context of the Partnership Agreement, it has an obligation to pay to limited partners a fair price and has violated that obligation, are matters that may be litigated hereafter."[24]

I. The Tender Offer Is Ultimately Successful

By the May 15, 1996 end date of the Offer, only approximately 30% of the limited partnership Units had been tendered. Consequently, Host raised the price to $150,000 and extended the offer until June 13, 1996. The revised Offer was successful, although only 50.4% of the limited partnership Units were tendered.

Two of the three original plaintiffs, MacKenzie and Wasserman, chose not to tender their Units. Salter, on the other hand, decided (or, as he would have it, was coerced) to tender.

J. The Refinancing is Accomplished

On September 23, 1996, the General Partner completed the refinancing for a total of $266 million. Of this amount, $222.5 million was attributable to the mortgage debt on the partnership's hotels and $43.5 was attributable to the Partnership's 50% stake in the Santa Clara property. As described by the Partnership's Form 10-Q, filed October 21, 1996, the refinancing was completed on terms very similar to those discussed in the Offer to Purchase. The Form 10-Q also announced that 1996 partnership distributions would be increased to at least $20,000 per Unit.

K. Distributions Increase Dramatically

Although the Offer to Purchase projected distributions of $11,612 per Unit for 1996 and $16,880 per Unit for 1997, the actual distributions per Unit were several times higher than projected. As described in the complaint:

> Having obtained the Units and control it sought, Host Marriott immediately doubled the per Unit distributions. In 1995, distributions were $4,615 per Unit in April and $10,385 per Unit in October. In 1996, distributions were $4,615 per Unit in April (just prior to the Tender Offer), and $33.123 per

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[24] *Id.* at 24.

> Unit by the end of 1996, following the Tender Offer's consummation. In 1997, distributions were $27,204. Thus the average annual distribution after Host owned a majority of the Units was $30,164 or double the average annual distribution prior to Host's purchase of those Units . . . . The Hotels' performance has improved only slightly during the year following the Tender Offer. Defendants failed to disclose . . . their plan to increase operating distributions following the Tender Offer [and] . . . affirmatively stated that there was a strong risk that future distributions would actually decrease.[25]

L. The December 1998 Merge

The complaint alleges that in December 1996 and January 1997, Host Marriott and its affiliates "were actively exploring the possibility of engaging in a business combination with a so-called 'paired-share' REIT." During the fourth quarter of 1997, Host Marriott began internal consideration of the possibility of reorganizing itself into a stand-alone real estate trust ("REIT"). In April 1998 Host publicly announced its decision to pursue the transaction, which closed in December of that year.

The transaction involved the merger of the Partnership into a subsidiary of a newly created "Operating Partnership" owning approximately 125 hotels. In the merger, Units were converted into units of the Operating Partnership, thus providing former Unitholders with interests in a much larger and more diversified entity.

The proposed exchange value of the partnership's Units, $237,334, was determined using appraisals and a fairness opinion from American dated March 1, 1998. Host attributed the change in Unit value following the Offer to increased profitability of the Partnership and decreased capitalization rates in the hotel industry.

III. DISCUSSION

A. Applicable Standards

1. Motion to Dismiss

[1-2] "[W]hen evaluating a motion to dismiss for failure to state a claim, the truthfulness of all well-pleaded allegations in the complaint is to be

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[25]Compl. ¶52

assumed."[26] Further, the plaintiff is entitled to all reasonable inferences that can be drawn from the complaint.[27] "However, '[c]onclusions . . . will not be accepted as true without specific allegations of fact to support them.'"[28] The motion to dismiss will be denied unless it appears with "reasonable certainty" that the plaintiff could not prevail on any set of facts that can be inferred from the pleading.[29]

2. Summary Judgment

[3-5] Relying on the Larson affidavit, discussed below, defendants have moved for summary judgment with respect to the claim that they failed to make distributions to which plaintiff was entitled. A motion for summary judgment will be granted when no genuine issue as to material fact exists and the moving party is entitled to judgment as a matter of law.[30] The moving party has the burden of clearly proving that no material factual dispute exists and the court resolves any doubt against the moving party.[31] Finally, if "a more thorough development of the record would clarify the law or its application," the court may, in its discretion, deny summary judgment.[32]

B. Plaintiff's Contentions and Legal Theories

[6] Plaintiff's theories of liability are varied and conceptually intertwined. Ultimately, one pertinent fact (and inferences reasonably drawn therefrom) precludes granting defendants' motions with respect to claims relating to their projections of and control over distributions to limited partners. Also, to the extent that the complaint states a disclosure claim and plaintiff was thereby not fully informed about the nature of his claim when he tendered his shares, he did not acquiesce in defendants' alleged misconduct.[33] For the reader's convenience, I think it useful to discuss the allegations that survive

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[26] *Solomon v. Pathe Communications Corp.*, Del. Supr., 672 A.2d 35, 38 (1996) (citing Grobow v. Perot, Del. Supr., 539 A.2d 180, 187 n.6 (1988)).

[27] *Id.* (citing *In re USACafes, L.P. Litig.*, Del. Ch., 600 A.2d 43, 47 (1991)).

[28] *Id.* (quoting *In re Tri-Star Pictures, Inc. Litig.*, Del. Supr., 634 A.2d 319, 326 (1995)).

[29] *Id.* (citing *In re USACafes*, 600 A.2d at 47; *Rabkin v. Philip A. Hunt Chem. Corp.*, Del. Supr., 498 A.2d 1099, 1104 (1985)).

[30] Ct. Ch. R. 56(c); *Gilbert v. El Paso Co.*, Del. Supr., 575 A.2d 1131, 1142 (1990).

[31] *See Brown v. Ocean Drilling & Exploration Co.*, Del. Supr., 403 A.2d 1114, 1115 (1979).

[32] *In re Dairy Mart Convenience Stores, Inc., Deriv. Litig.*, Del. Ch., Consol. C.A. No. 14713, mem. op. at 31, Chandler, C. (May 24, 1999).

[33] *See Siegman v. Columbia Pictures Entertainment, Inc.*, Del. Ch., C.A. No. 11152, mem. op. at 19, Hartnett, V.C. (Jan. 12, 1993).

defendants' motions and then to explain briefly why certain of plaintiff's other theories cannot be sustained.

First, plaintiff's claims are as follows.

1. Applicability of the Entire Fairness Standard to Transactions Between Host Marriott and the Limited Partnership

Plaintiff argues that the entire fairness standard must apply to the Offer. This result is warranted, according to plaintiff, because the combined effect of the Offer and the Amendments was like that of a merger and Host, therefore, stood on both sides of the transaction. The absence of any process to ensure fairness to the limited partners, according to plaintiff, warrants a finding against the defendants.

2. Alleged Breaches of the Partnership Agreement

Although conceding that the subject of a tender offer by Host Marriott for limited partnership interests "was not contemplated by the parties" or treated expressly in the partnership agreement, the Complaint alleges that the Offer nevertheless breached that contract. Plaintiff's theories are: (a) the Offer should have been governed by the terms of §5.02(B)(ii) of the partnership agreement, (b) Host Marriott breached the implied covenant of good faith and fair dealing, and (c) Host Marriott breached the implied obligation to pay a fair price in the Offer.

3. Alleged Breaches of Fiduciary Duty

Broadly speaking, the defendants are alleged to have breached their fiduciary duties as follows: (a) by failing to seek out the highest available price in the sale of the limited partnership, (b) by offering and paying an unfair price, (c) in the case of the General Partner and its directors, by (1) inadequately responding to the threat posed by the Offer to the limited partners and the Partnership and (2) disloyally manipulating the Partnership's affairs so as to benefit Host instead of the limited partners, (d) by coercing the Unitholders into tendering, and (e) by disseminating a false and misleading Offer to Purchase in connection with the Offer.

C. Summary of Conclusions

[7] Because of the interplay between several of plaintiff's theories, I think it useful to summarize my conclusions at the outset.

- The challenged transaction was a tender offer, and *not* a merger. Therefore, the entire fairness standard does not apply to the transaction simply because Host controlled the General Partner;

- Plaintiff's contract claims are dismissed;

- Plaintiff's *Revlon* claim is dismissed;

- The General Partner was under no fiduciary duty to protect the limited partners from the Offer. Viewing the evidence in the light most favorable to plaintiff, however, further discovery is necessary to determine whether the General Partner acted disloyally in limiting distributions, i.e., whether the General Partner managed distributions of Partnership cash *in contemplation of and to facilitate* the Offer;

- The Offer was not actionably coercive;

- Plaintiff's disclosure claims will be dismissed except for those relating to the projected distributions.

D. Claims Relating to Distributions Will Survive Defendants' Motions

1. Was the Disclosure Regarding Distributions Materially Misleading?

[8-10] The law is well-settled that "in extending an offer to the limited partners to buy their limited partnership Units the general partner owes a duty of full disclosure of material information respecting the business and value of the partnership which is in its possession."[34] The legal test for materiality, identified by the United States Supreme Court in *TSC Industries, Inc. v. Northway, Inc.*[35] and adopted by the Delaware Supreme Court in *Rosenblatt v. Getty Oil Co.*,[36] is stated as follows:

> An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in

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[34]*PI Opinion* at 20 (citing Alan R. Bromberg & Larry E. Ribstein, *Bromberg and Ribstein on Partnerships* § 6.07 (1994); *Shell Petroleum, Inc. v. Smith*, Del. Supr., 606 A.2d 112 (1992)).

[35]426 U.S. 438 (1976).

[36]Del Supr., 493 A.2d 929, 944 (1985).

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

Where, as here, the lone source of disclosure is a fiduciary having a conflicting interest, an obligation of complete candor is imposed on the fiduciary and judicial scrutiny of the disclosure is more exacting.[37]

Defendants projected a short-term decrease in the amount of cash distributions to limited partners. The Offer to Purchase projected distributions extending for ten years, never exceeding $30,000. Although the possibility of increased future distributions was discussed, defendants indicated a belief that the cash reserves would be maintained, presumably leaving distributions unaffected. Soon after the Offer closed in June 1996, however, distributions increased so that Unitholders received over $33,000 in that year alone. In light of the timing of defendants' change of policy, plaintiffs are entitled to an inference, at this stage of the proceedings, that defendants did not believe the projections when they made them. As such, aspects of defendants' motion to dismiss that relate to distributions must be denied.

Defendants warn the court of the *post hoc ergo propter hoc* fallacy.[38] The issue presented, however, is not one of causation. Instead, it is that distributions *rose so dramatically* and *so soon* after defendants' disclosure indicated the contrary expectation that, at this preliminary stage, a predicate exists for inferring that the disclosures were false when made.

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[37]*See Eisenberg v. Chicago Milwaukee Corp.*, Del. Ch., 537 A.2d 1051, 1057 (1987); *Sonet v. Plum Creek Timber Co.*, L.P., Del. Cg., C.A. No. 16931, Jacobs, V.C., mem. op. at 18-19 (March 18, 1999).

[38]Defendants cite *Edward J. Sweeney & Sons, Inc. v. Texaco, Inc.*, 637 F. 2d 105, 116 (3d. Cir. 1980) ("Logicians describe one process of reaching an ultimate fact from insufficient basic facts as the *false cause* or *post hoc* fallacy. The fallacy consists of reasoning from sequence to consequence, that is, assuming a causal connection between two events merely because one follows from the other. For this reason the fallacy is often referred to as that of *post hoc ergo propter hoc* (after this and therefore in consequence of this), an expression which itself explains the nature of the error."), *cert. denied*, 451 U.S. 911 (1981).

Defendants present two arguments against such an inference. First, they cite my opinion in *Sanders v. Devine*[39] and Vice Chancellor Jacobs's opinion in *Noerr v. Greenwood*[40] as support for its position that the "fact that an issuer has immediate access to information about the company's financial status does not support an inference that it knows the future."

In the circumstances, neither case is helpful to defendants. *Noerr* can be distinguished because, while numerous factors beyond a board's control may contribute to stock price fluctuations, the Partnership's distribution policy was unilaterally controlled by the General Partner. *Sanders* is inapplicable because in that case, (a) no "secret plan" was alleged in the complaint, (b) a "secret plan" theory was fundamentally inconsistent with the overall theory of the complaint,[41] and, critically, (c) plaintiff sought to allege a conspiracy concocted over five years before it was executed.

The present complaint, on the other hand, alleges that the General Partner disclosed facts about its distribution policy and within months, *unilaterally* made a dramatic change in course. There may well be a good explanation for this change. Because the current record provides none, however, further inquiry is warranted.

Defendants also argue that the Offer to Purchase disclosed that the refinancing would soon be accomplished and that the reserves were created to provide cash needed to consummate the refinancing. As such, defendants claim that "the 'foreseeable future' did not necessarily include endless reserves."

I agree, as did Chancellor Allen,[42] that some limited partners must have recognized that Host, once it stood to benefit from doing so, might cause the General Partner to change its distribution policy. Those perceptive investors refused to tender and profited handsomely. However, by (a) making projections that did not contemplate any significant increase in distributions based on terminating the lender reserves and (b) affirmatively suggesting that a "significant portion" of the reserves would be needed to accomplish the proposed refinancing, defendants provided the basis for an

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[39]Del. Ch., C.A. No. 14679, mem. op. at 22-23, Lamb, V.C. (Sept. 24, 1997) ("The mere fact that Ford cashed-out the Shares, as they were fully entitled to do, cannot now be used, without more, to infer that Ford had formed a "secret plan back when the shares were first issued.")

[40]Del. Ch., C.A. No. 14320, mem. op. at 12-13, Jacobs, V.C. (July 16, 1997) ("[A]llegations of 'fraud by hindsight' are not enough to state a cognizable claim of misrepresentation. . . . A subsequent stock price increase, without more, does not prove that the directors knew that the market value of the optioned shares would exceed the exercise price at the time they sought shareholder approval for the grant.")

[41]*Sanders* at 23 (noting that other facts alleged in the complaint alleged that Ford decided to reconsolidate Ford Holdings in response to the unanticipated level of profitability).

[42]*PI Opinion* at 24 ("For those who prefer to hold their investment, the fact that the general partner will, if the deal closes, receive a share of distributions chiefly in its role as limited partner may indeed offer some assurance not previously available.").

inference by limited partners that the reserves would stay in place and distributions would remain constricted. In the circumstances, plaintiff must be given further opportunity to explore when and why the distribution policy changed.

Several of plaintiff's disclosure claims may turn on the resolution of this issue, and are therefore not subject to dismissal. As discussed, the projected distributions may prove to be false and misleading. Second, if defendants planned, in April 1996, to increase distributions after the refinancing, they were obliged to disclose that plan as part of the expected benefit to Host upon completing the Offer. Third, it is unclear, based on the present record, whether plaintiff's claim that defendants failed to disclose the possibility of an excess refinancing distribution is linked to the disclosure regarding projected distributions. In other words, it may be that the increase in distributions was based, in part, on excess refinancing proceeds. Along those lines, if such increase was expected, it should have been disclosed.

Finally, a finding that the projections were false may also impact the validity of the valuation performed by American. Specifically, one of the valuation methods employed by American was a "Unitholder Cash Distribution Analysis."[43] If Host withheld from American a plan to change the distribution policy, Host may have breached its fiduciary duties.[44]

2. The Summary Judgment Issue: Was the Tender Offer Tainted by the General Partner's Disloyal Manipulation of Unit Value?

Defendants have moved for summary judgment on plaintiff's allegation that defendants failed to make distributions to which the limited partners were entitled, arguing that "the undisputed facts show that creation of the reserves was within the General Partner's reasonable discretion." In support of their argument, defendants present an affidavit filed by Gregory Larson, a manager for Host, in connection with the preliminary injunction hearing in 1996.[45] At that time, Larson stated that "[t]he Partnership has

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[43]Offer to Purchase at A-5 - A-6.

[44]*See Joseph v. Shell Oil Co.*, Del. Ch., 482 A.2d 335, 341 (1984) (finding, on a motion for preliminary injunction, that the fiduciary tender offeror retained an expert to render a fairness opinion, but withheld "essential facts necessary for [the expert] the arrive at a fair and accurate opinion as to [share] value" and holding that such withholding of material information "would appear to be a breach of fiduciary duty aside from any issue of failure to make full disclosure").

[45]In connection with the present motion, defendants provided the affidavit of Robert E. Parsons, Jr. The Parsons affidavit states that during the Offer, Host "had no plans or proposals for any extraordinary transaction, such as a merger, reorganization or sale or transfer of a material amount of assets, involving the Partnership." Plaintiff does not argue that the REIT merger was contemplated in 1996. The Parsons affidavit is more notable for information it does *not* provide, namely, there is no explanation of the circumstances surrounding the increase in distributions in 1996.

not been 'stockpiling cash in anticipation of the tender offer' as alleged by plaintiffs in this action. Rather, over the last four years, the Partnership has established and funded reserve accounts in anticipation of its mortgage debt refinancing."

Although this affidavit gives a plausible explanation for the policy, defendants ignore the nature of plaintiff's claim. Plaintiff is not, as defendants characterize it, alleging simply that he was *entitled* to distributions. Indeed, in light of this affidavit, such argument would fail.[46]

Rather, plaintiff argues that even if the General Partner's authority over distributions was broad, its power was not unfettered. Specifically, the fortuitous timing of the General Partner's change in distribution policy calls into question the good faith of the General Partner's management decisions in the time period preceding the Offer. This aspect of plaintiff's position is connected to the surviving disclosure issues, as follows: if defendants anticipated that distributions would increase shortly (the core of the disclosure claim), they may have created and/ or maintained the cash reserve at an artificially high level in order to lower the limited partners' perception of Unit value (the core of the loyalty claim).

Plaintiff argues that "[g]iven Defendants' refusal to increase distributions notwithstanding their ability to do so, Unitholders perceived that, unless they tendered, they would be faced with a return limited to $15,000 per Unit for the foreseeable future."[47] Further, plaintiff argues that the six month delay of the refinancing and the increase in distributions shortly after the Offer closed "allows a reasonable inference that the creation and maintenance of cash reserves were improperly designed for the benefit of Host, not the limited partners . . . ."

[11] Plaintiff's claim is analogous to that made in *Litle v. Waters*,[48] where the plaintiff alleged that the defendant had frozen dividends in order to effectuate an oppressive squeeze-out. Under the authority of *Litle*, if plaintiff can prove mat the General Partner limited distributions in

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[46]As previously mentioned, the Partnership Agreement specifically and explicitly addresses distributions to the limited partners, requiring that all "Cash Available for Distribution... shall be distributed at least semi-annually . . . ," with the caveat that such distributions may be reduced as the general partner "reasonably determines necessary to provide for the [g]oing operation of the Partnership." Sections 1.01 and 4.06(B). However, excess cash reserves "no longer necessary to provide for the foreseeable needs of the Partnership" must be added to the current revenues available for distribution.

[47]Generally, the value of the entity should be increased when cash is retained. Tthe complaint alleges that "[i]f a Unit returning $15,000 per year is worth $150,000, that same Unit returning $30,000 is worth $300,000." This statement is, for obvious reasons, not entirely accurate. In light of the lack of liquidity for the Units, however, I find it reasonable to infer that cash distributions represented a significant aspect of Unit value. Further, the delay of the refinancing at least marginally increased the financial risk of the Partnership.

[48]Del. Ch., C.A. No. 12155, Chandler, V.C. (Feb. 11, 1992).

anticipation of the Offer, that decision could be viewed as an interested transaction subject to heightened judicial scrutiny.[49] I must note that the facts alleged in Litle evidenced a more obvious form of inequitable conduct than the situation presented here.[50] Nevertheless, because neither of defendants' affidavits nor any other evidence elucidates the circumstances surrounding the significant shift in distribution policy, further proceedings are needed to determine the law's application to the facts.[51]

I note that the burden of proof at trial will remain, at the outset, on plaintiff. "Nevertheless, on the motion for summary judgment, the movant, to prevail, must still demonstrate that there are no material issues of fact in dispute."[52] Further discovery is needed to develop facts regarding the timing, motivation and effect of the General Partner's decisions.

E. The Remaining Claims in the Complaint Will be Dismissed

Keeping in mind the issues remaining to be litigated, I think it useful to discuss the aspects of the complaint that will be dismissed for failure to state a claim.

1. The Entire Fairness Standard Does Not Necessarily Apply to Transactions Between the General Partner or its Affiliates and the Limited Partners

The parties agree that Host Marriott controlled the General Partner. Host Marriott was the offeror. Plaintiff therefore states that because Host Marriott stood on both sides of the transaction, the entire fairness standard should apply.[53]

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[49]*Litle* at 8-11 (holding that a claim was stated where, by not declaring dividends in the context of a Subchapter S Corporation, defendant was "putting himself in a position to to acquire a full 1/ 3 of [the company's] stock at a discount"; *see also* 8 *Del. C.* § 144.

[50]*Litle* at 2-4.

[51]*See In re Dairy Mart Convenience Stores, Inc., Deriv. Litig.*, Del. Ch., Consol. C.A. No. 14713, mem. op. at 31, Chandler, C. (May 24, 1999). I note plaintiff's claim that Larson's "self-serving affidavit" is controverted by the Vodola affidavit, which "identifies cash available for distribution of more than $20 million in excess of the reserves identified by Larson." As defendants point out, the Vodola affidavit merely states that if the Partnership were liquidated in 1996, there would be $20 million in cash or cash equivalents available for distribution. Thus, the affidavit does little or nothing to further plaintiff's burden of showing that the funds actually set aside in cash reserves were done so for the purpose of suppressing Unit value.

[52]*See Siegman v. Columbia Pictures Entertainment, Inc.*, Del. Ch., C.A. No. 11152, mem. op. at 15, Hartnett, V.C. (Jan. 12, 1993).

[53]*See Weinberger v. UOP, Inc.*, Del. Supr., 457 A.2d 701 (1983).

[12] Plaintiff recognizes the distinction between a tender offer and a merger.[54] However, plaintiff argues that the combination of the Offer and the Consent Solicitation amounted to a reorganization akin to a merger. If that were true, a duty of entire fairness would theoretically apply.[55] However, there is a fundamental difference between a merger, in which the General Partner (or, in the corporation context, the board of directors) plays an integral role, and a tender offer, in which the offeror deals directly with the limited partners (or the stockholders). The facts of this case do not blur the line to such an extent that I can treat the transaction as a merger.

[13] If one party stands on both sides of a transaction, it might effectuate changes to the detriment of fellow investors. In such situations, the entire fairness test properly applies to protect minority stockholders from the tyranny of the controlling entity. In the present case, however, Host Marriott stood on one side of the transaction and the limited partners on the other. It would be exceedingly paternalistic and intrusive to hold that the entire fairness test is required to protect the limited partners from themselves.

That the Amendments were presented to the limited partners in connection with the Offer does not alter the voluntary nature of either the Consent Solicitation or the Offer. As I discuss in section III.E.5, *infra*, by presenting the Amendments and the Offer together, limited partners had more, not less, freedom of choice. In the circumstances, I see no reason to depart from the rule that tender offers are not subject to an entire fairness standard.

2. *Revlon* Duties Do Not Apply

Plaintiff initially asserted that defendants breached their fiduciary duties to consider or pursue alternatives to the refinancing and tender offer, consistent with the Supreme Court's holding in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[56] These contentions were considered rejected in the Dismissal Opinion, when I stated:

> In denying preliminary injunctive relief Chancellor Allen held, on a preliminary basis, that the structural elements of the partnership giving [the General Partner] effective control over the management and disposition of the assets of the partnership precluded a finding that the limited partners were entitled to any premium for the passage of "control." . . . Thus, he rejected

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[54]The review standard for fiduciary tender offers is discussed in section III.E.5, *infra*.
[55]*See generally Weinberger*, 457 A.2d 701.
[56]Del. Supr., 506 A.2d 173 (1986).

> plaintiff's contention that defendants breached their fiduciary duties by failing to solicit possible alternative transaction.... This conclusion would seem to be consistent with, and, indeed, compelled by applicable Delaware precedent.[57]

Plaintiff apparently concedes the lack of merit in his argument, as he does not address this aspect of defendants' motion. However, even if he does not make such a concession, my previous ruling is dispositive on this allegation. This aspect of the complaint is hereby dismissed as a matter of law.

3. Plaintiff's Contract Claims Must be Dismissed

Plaintiff's breach of contract claims involve provisions of the partnership agreement intended to provide the limited partners with a procedure to ensure the fairness of transactions between the Partnership and the General Partner or its affiliates. Section 5.02(B)(ii), in particular, governs the sale of Partnership assets (the hotels) to the General Partner or its affiliates, and prescribes a fixed procedure, including independent appraisals and a vote of the limited partners. These provisions are plainly inapplicable to the Offer. Plaintiff's contract argument is three-fold.

a. Section 5.02(B)(ii)

[14] Plaintiff firsts contends that the Offer constituted a "sale of the hotels" and triggered the appraisal process required by section 5.02(B)(ii). I disagree. Section 5.02(B)(ii) was clearly intended to apply to a sale of the partnership's *assets, i.e.*, the hotels, not to a tender offer for the Units. The two cannot be equated. Section 17-701 of the Delaware Revised Uniform Limited Partnership Act,[58] states: "A partner has no interest in specific limited partnership property," and has been interpreted to preclude the attempt to equate ownership interests in a partnership with ownership of partnership property.[59] Thus, plaintiff's first argument must fail, as there was no "sale of the hotels" sufficient to invoke the protections of section 5.02(B)(ii).

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[57] *Mem. op.* at 10-1 1 (citations omitted).

[58] 6 *Del. C.* §17-701.

[59] *See, e.g., International Business Machines Corp. v. Corndisco, Inc.*, Del. Super., C.A. No. 91C-07-199, 1991 WL 269965, *14, Goldstein, J. (Dec. 4, 1991) (citing to section 17-701and noting that plaintiff's *partnership interest* entitled it to bring a conversion action on behalf of the partnership, but did not entitle it to bring the action on its own behalf, as plaintiff did not have any *ownership interest* in the partnership's property).

b. *Implied Covenant of Good Faith and Fair Dealing*

Plaintiff next contends that defendants breached the implied covenant of good faith and fair dealing. Assuming that the Offer did not trigger the protections of section 5.02(B)(ii), plaintiff argues that the intention of the Offer was to circumvent that section, in that "[t]he tender offer transferred the economic benefits of the operation of the Hotels from a majority of the limited partners to an affiliate of the General Partner in a manner that avoided the protections of the independent appraisal process."

This argument also fails. Nothing in the agreement precludes the General Partner or its affiliates from making a tender offer for the Units. I will neither assume nor infer, based on this allegation, that defendants chose to structure the transaction as a tender offer, as opposed to a sale of assets, merely to circumvent the agreement's appraisal provisions.

Moreover, there is a critical distinction between a sale of the hotels, which (if approved by the requisite number of limited partners) would affect *supporters and dissenters alike* and a tender offer, in which the assets underlying the Units would remain unchanged. Thus, the rationale for contractually limiting the General Partner's participation in a sale of the hotels does not apply in the tender offer context, and the Offer cannot be viewed as a way to circumvent the contract's intent.

c. *Implied Obligation to Establish a Fair Price*

[15] Plaintiff's last argument is that defendants breached an obligation they imply from the terms of the partnership agreement to ensure fairness in any transaction involving the General Partner. This obligation is said to arise from the parties' expectation, because "[t]he framework of the Partnership Agreement . . . - including the "blue sky" process designed to protect the investors -compels the conclusion that had the issue been addressed, the price of a tender offer by the General Partner or its affiliates would have been determined by an independent valuation process akin to the appraisal process set forth in Section 5.02(B)(ii)." In support of this argument, plaintiff quotes from *Schwartzberg v. Critef Assocs., L.P.*, as follows:

> It is of course generally recognized that implicit obligations consistent with the text of written obligations may, indeed under correct conditions should be inferred under both statutes and contracts. . . . [A] n [implied contractual] obligation may be inferred when, given the terms of the express contract made and the circumstances of the contracting process, it is more likely than not . . . that if the parties had thought to address the

> subject, they would have agreed to create the obligation that is under consideration by the court *ex post facto*.[60]

[16] Essentially, plaintiff asks me to rewrite the partnership agreement to include an independent valuation process for a non-interested transaction between an affiliate of the General Partner and the limited partners. I will not do so. I recognize that there are unusual factual situations where it is appropriate for the court, based on the surrounding circumstances, to draw from and enforce implied obligations in contracts.[61] However, where such a situation is not present, the law is well-established that "it is not the proper role of a court to rewrite or supply omitted provisions to a written agreement."[62]

I see no basis to draw the inference plaintiff seeks. The drafters of the partnership agreement crafted a protective provision designed to ensure that in a self-interested transaction, specifically a sale of the hotels to the General Partner or one of its affiliates, the Partnership would receive a fair price for its property. A similar provision, providing for an independent valuation process in the event of a tender offer by the General Partner or its affiliates, could have been made a part of the agreement but was not. Due to the essentially voluntary nature of tender offers, I will not imply an intention to subject them to some independent appraisal process.

For the above reasons, plaintiff's contract claims must be dismissed.

4. The General Partner Was Under No Duty to Protect the Limited Partners From the Threat of an Unfairly Priced Offer

Plaintiff claims that the General Partner's "failure to take steps to protect the limited partners in response to its affiliate's unfair and misleading proposal," amounted to breach of the General Partner's duty of due care and good faith. Such a breach is alleged to be shown by the General Partner's failure: (a) to retain an outside advisor to opine as to the fairness of the offer, (b) to form a committee of Unitholders to independently evaluate the offer and (c) to resolve or at least minimize conflicts of interests in favor of the Unitholders. Plaintiff cites *Unocal Corp. v. Mesa Petroleum Co.*, where the Supreme Court stated, "in the broad context of corporate governance,

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[60]Del. Ch., C.A. No. 14837, mem. op. at 20, Allen, C. (June 7, 1996) (citations omitted).

[61]*See Cincinnati SMSA L.P. v. Cincinnati Bell Cellular Sys. Co.*, Del. Supr., 708 A.2d 989, 992-93 (1998) (noting that the courts of the state will "cautiously" supply a missing term to a written agreement "[i] n cases where obligations can be understood from the text of a written agreement but have nevertheless been omitted in the literal sense").

[62]*Id.* at 992.

including issues of fundamental corporate change, a board of directors is not a passive instrumentality."[63]

Plaintiff also relies on a comment I made during oral argument on an earlier motion to dismiss in this case, in which I referred to Vice Chancellor Jacobs' decision in the *Sealy Mattress* case[64] and suggested some criticism of the General Partner's passivity in response to the Offer.

Plaintiff's argument is premised on an analogy to principles of corporate fiduciary duty law that, after full consideration, I cannot accept. It is simply unreasonable and inappropriate to impose on the General Partner or its directors (all of whom were controlled by Host) an obligation to have acted independently of Host in relation to the Offer, which was, after all, structured as a voluntary transaction between Host and the limited partners.

In denying the preliminary injunction, Chancellor Allen noted "the significance of operating within the context of rather highly specified rights of this limited partnership."[65] Important among those "highly specified rights" are two express contractual provisions limiting the freedom of Host and the General Partner to act in certain conflict of interest situations. These "rights" are the appraisal process in the case of a sale of hotel properties, previously discussed, and a restriction on the General Partner's power to change the terms of the management agreements to increase "the compensation payable to the General Partner or any of its Affiliates, or which adversely affects the rights of the Limited Partners."[66] Both of these conflict situations involve transactions in which individual limited partners would not have an exercisable choice of whether or not to participate. Thus, they would be bound by the action of the General Partner or by a vote of the majority. The fact that the Partnership Agreement eliminated the General Partner's involvement in these conflict situations makes clear that the limited partners anticipated and understood that they could not rely on the General Partner to act on their behalf when Host's interests were directly adverse. [17] The situation at issue here — a tender offer by the General Partner or one of its affiliates — was not addressed in the partnership agreement. No contractual provision was needed, however, because the law provides a framework that is well-suited to the individual and essentially voluntary nature of such a transaction.[67] Unlike a third party tender offerer, who is subject to no *fiduciary* duties to the target-company stockholders, Host was

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[63]Del. Supr., 493 A.2d 946, 954 (1985).

[64]*Sealy Mattress Co. of New Jersey, Inc. v. Sealy, Inc.*, Del. Ch., 532 A.2d 1324 (1987).

[65]*PI Opinion* at 10.

[66]Partnership Agreement § 5.02(B)(iii).

[67]This fact provides another basis for concluding that the absence of an independent valuation process in the Offer did not violate the implied covenant of good faith and fair dealing in the partnership agreement. *See* section III.E.3.b, *supra*.

unquestionably subject to the requirement of Delaware law that its Offer be made with complete disclosure and be non-coercive.[68] In my judgment, this is an adequate framework to protect the interests of the limited partners without imposing an awkward and overly formalistic version of *Unocal* duties on persons controlled by Host.[69]

I also note that, except for allowing the Amendments to be voted upon, no act of "corporate governance" was required to complete the transaction. This distinguishes the matter from the freeze-out merger contested in *Sealy*, in which the defendant board, albeit controlled, was nevertheless obliged by statute[70] and established law, "to make an informed, deliberate judgment, in good faith, that the merger terms, including the price, were fair and that the merger would not become a vehicle for economic oppression."[71] This aspect of plaintiff's claim is dismissed.

5. The Offer Was Not Coercive

[18-19] Delaware law is well-settled that "the adequacy of the price in a tender offer does not raise a triable issue unless price is connected to valid claims of breach of fiduciary duty, such as disclosure problems or actionable coercion."[72] Chancellor Allen relied on this principle of law in denying the preliminary injunction and it applies in the context of this motion to dismiss.[73] The premise underlying the law's treatment of a tender offer is "the understanding that tender offers are voluntary transactions; that is, that [Unitholders] each have a free choice to . . . tender or not at a given price."[74]

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[68] *PI Opinion* at 12.

[69] I also find it useful to consider the structure and purpose of the Partnership in assigning fiduciary duties, such as those recognized in *Unocal*, to the General Partner or its directors. The Partnership was formed by Host Marriott as a vehicle to finance the ownership of several hotels managed by another Marriott entity under long term management agreements. Host's ownership of partnership equity was quite limited but its control over partnership affairs nearly complete. A wholly-owned subsidiary of Host was named as the General Partner and its directors were all persons associated with Host. The Partnership had no operations other than to collect fees paid to it under the management agreements, service the debt incurred to purchase the hotels and make distributions to the limited partners.

I conclude that these factors support a clear conclusion that the limited partners neither expected nor had any right to expect, that the General Partner or its directors would seek to act independently of Host in relation to the Offer.

[70] 8 *Del. C.* § 251(b) ("The board of directors . . . *shall adopt a resolution* approving an agreement of merger or consolidation." (emphasis added)).

[71] 532 A.2d at 1335.

[72] *Solomon v. Pathe Communications Corp.*, Del. Ch., C.A. No. 12563, mem. op. at 13, Allen, C. (Apr. 21, 1995), *aff'd*, Del. Supr., 672 A.2d 35 (1995); *See also Lynch v. Vickers Energy Corp.*, Del. Ch., 351 A.2d 570, 576 (1976), *rev'd on other grounds*, Del. Supr., 383 A.2d 278 (1977).

[73] *See PI Opinion* at 12.

[74] *In re Life Technologies, Inc., Shareholders Litig.*, Del. Ch., Consol. C.A. No. 16513,

Unless the complaint can be read to adequately plead a claim of coercion or a disclosure violation, plaintiff's fair price claim is subject to dismissal.[75]

It is hard to take seriously a claim that plaintiff and others were "coerced" into tendering when the Offer failed to attract a large majority of the limited partnership Units by its initial closing date. Only after Host raised its price by 20% to $150,000 per Unit and extended the term of the Offer did it succeed in attracting tenders of more than 50% of the Units and, even then, only barely so. Can it be that a non-frivolous tender offer that fails to attract tenders is, nonetheless, actionably "coercive?" If not, can that offer become actionably coercive simply by a 20% increase in its price term?

Whatever the answer to those questions may be in the abstract, it is clear in this case that no coercion is alleged. That is, there was no threatened bad consequence resulting from the conduct of Host or the General Partner that compelled a decision to tender. I am mindful that the decision of each limited partner whether or not to tender entailed a weighing of the price offered against the perceived risks and rewards of continuing to hold the investment. Just because Salter and others ultimately decided that it was in their best interest to sell, rather than continue to hold their limited partnership interest, however, does not mean that they were "coerced" into doing so in any legally meaningful sense.

[20] Plaintiff attempts to characterize as "coercion" the fact that, if the tender offer was successful (and the Amendments approved), nontendering Unitholders, as a group, would lose the capacity to control the vote independently of the General Partner. Chancellor Allen was unable to identify in that fact "an actual threat to the investment interests of the limited partners from the general partner's acquiring a majority" of the limited partnership voting power.[77] There is nothing in the present complaint that suggests a different conclusion. Tender offers for majority control regularly occur and have never been found coercive for that reason alone.

[21] Plaintiff also claims that the Offer was actionably coercive because there were, potentially, adverse tax implications to nontendering Unitholders, as described in the Offer to Purchase. Chancellor Allen concluded that this claim failed as a matter of law because "[t]o hold that the collective action effect of the tax constitutes a reason why a fiduciary cannot extend an any and all offer would sharply reduce the availability" of potentially valuable transactions.[78] I concur.

Tr. at 4, Lamb, V.C. (Nov. 24, 1998).

[75]As discussed in section III.D.1, *supra*, a disclosure claim is stated. If the facts and inferences alleged in the complaint are proven, defendants may be under a duty to pay a fair price.

[77]*PI Opinion* at 18.

[78]*Id.*

Next, plaintiff claims that the tendering Unitholders "were forced to vote for the amendments as a condition of the sale of their Units even though these amendments would be irrelevant to the tendering Unitholders." This is an exercise in illogic. In fact, the concurrent but independent existence of the Consent Solicitation and the Offer gave Unitholders more freedom of choice rather than less. Specifically, Unitholders who wanted the Offer to fail but wanted to be bought out if it succeeded had an effective strategy. They could simultaneously tender and withhold consent. Similarly, those who wished to see the Offer succeed but did not want to sell could refuse to tender but consent to the Amendments. In theory, at least, the only group that both tendered and gave a consent were those who both wanted the Offer to succeed and wanted to participate in it. To them, the Consent Solicitation was an obstacle to the desired end, not a goad to agree to changes not otherwise in their interest.

[22] Finally, plaintiff contends that the Unitholders were "coerced" into tendering because the General Partner told the Unitholders that the refinancing of the mortgage debt could be seriously detrimental to them, i.e., by restricting any sale of the hotels for a ten-year term, prohibiting pre-payment of the debt, and increasing future debt service. Although complaining of their coercive effect, plaintiff does not dispute the accuracy of these statements as they relate to the successful completion of the Offer. Accurate descriptions of the consequences of a successful tender offer do not amount to coercion.[79] As the Supreme Court observed in *Williams v. Geier*:

> The simple answer . . . is that the Proxy was merely stating facts which were required to be disclosed. These disclosures were neutrally stated and were not threatening in any respect. . . . The board could not couch these disclosures in vague or euphemistic language or in terms that would deprive the stockholders of their right to choose. The disclosures must be forthright and clear, and they were in this case.[80]

The same reasoning applies here. The Offer to Purchase and the General Partner's Schedule 14D-9 merely disclosed neutral, non-threatening factual possibilities that could be considered important by a Unitholder in determining whether or not to tender his or her Units. This claim also fails and is dismissed.

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[79] *See Williams v. Geier*, Del. Supr., 671 A.2d 1368, 1382-84 (1996).
[80] 671 A.2d at 1383.

6. Disclosure Violations

The complaint also alleges that defendants "purposefully failed to provide full, truthful and adequate information to the limited partners," and that such disclosure violations warrant a duty to pay a fair price in the Offer. The legal standard for a disclosure claim in the context of a tender offer by a fiduciary is discussed in section III.D.1, *supra*. I have already discussed plaintiffs' allegations of non-disclosure or misrepresentation that are connected to distributions. I turn now to plaintiff's remaining allegations.[81]

a. Cash Not Disclosed in the Unit Valuation

Under the "Net Asset (Break Up) Analysis" valuation method[82] used by American, and presented to the Unitholders as part of the Offer, the median value of an individual Unit was presented as $104,000. Defendants represented that this analysis was based on appraisals of the hotels, and cash and cash equivalents were added to calculate the net value to Unitholders. Plaintiff contends, based on expert advice, that the amount of cash available at liquidation results in an additional $71,000 per Unit, and that this large figure is plainly inconsistent with the $104,000 estimate. Defendants counter by arguing that plaintiff simply "quarrel[s] with American Appraisal's method of analyzing data that was fully disclosed in the offering documents."

[23] I agree with defendants that plaintiff's claim merely presents a "quarrel over methodology." It may be that plaintiff's expert's approach is

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[81]While plaintiff's opposition brief focuses on the six categories described above, the complaint alleges additional disclosure violations, including; the Offer's failure to mention that American Appraisal was not an independent appraiser, as it had a "lucrative long-standing relationship with Host Marriott and the following allegedly "material" facts: (1) the General Partner's analyses regarding the possible disposition of Partnership properties, (2) defendants' business plans and details regarding the expected refinancing and the value of the defendants' anticipated profits flowing from the Offer and (3) whether actions alternative to the Offer, such as asset sales, liquidation or merger, would be appropriate and why such actions have not been explored. Compl. ¶ 50.

As plaintiff has not addressed these alleged disclosure violations in briefing this motion, I see little need to go into an in depth analysis of each of them. Suffice it to say that they suffer from similar defects as those disclosure allegations discussed above and do not survive defendants' motion to dismiss. Specifically, I find that the Offer sufficiently disclosed that Host Marriott had a previous business relationship with American Appraisers. As for the remainder of plaintiff's alleged violations, I find that they have either been sufficiently disclosed, or are not material to a decision of whether to tender.

[82]In the complaint, plaintiff, in addition to attacking the Net Asset method, also attacks three other valuation methods used by American Appraisers. Compl. ¶ 46. As plaintiff has not briefed his dispute with these other methodologies, I assume that they are no longer at issue.