Pages 1, 66, and 75 have been corrected.

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

GOTHAM PARTNERS, L.P., a New York Limited Partnership,

Plaintiff,

v.

HALLWOOD REALTY PARTNERS, L.P., HALLWOOD REALTY CORPORATION, and the THE HALLWOOD GROUP INCORPORATED, ANTHONY J. GUMBINER, BRIAN M. TROUP, WILLIAM L. GUZZETTI, ALAN G. CRISP, WILLIAM F. FORSYTH, EDWARD T. STORY, and UDO H. WALTHER,

Defendants.

Civil Action No. 15754

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DIANNE H. KEMPSKI

MEMORANDUM OPINION

Date Submitted: May 1,200 1
Date Decided: July 18,200 1
Date Corrected: August 1,200 1

Edward M. McNally, Esquire, of MORRIS, JAMES, HITCHENS & WILLIAMS, Wilmington, Delaware; OF COUNSEL: Philip H. Schaeffer, Dwight A. Healy, Karen M. Asner, David G. Hille, Esquires, of WHITE & CASE, New York, New York, Attorneys for Plaintiff.

Michael D. Goldman, Stephen C. Norman, and Matthew E. Fischer, Esquires, of POTTER ANDERSON & CORROON, Wilmington, Delaware; Attorneys for Defendants Hallwood Realty Corporation, The Hallwood Group Incorporated, Anthony J. Gumbiner, Brian M. Troup, and William L. Guzzetti.

Elizabeth M. McGeever, Esquire, of PRICKETT, JONES & ELLIOTT, Wilmington, Delaware, Attorneys for Defendants Hallwood Realty Partners, L.P.

STRINE, Vice Chancellor

Plaintiff Gotham Partners, L.P. brought this action challenging the following transactions consummated by nominal defendant Hallwood Realty Partners, L.P. (the "Partnership"). Through action by the Partnership's "General Partner," defendant Hallwood Realty Corporation, the Partnership executed:

- The "Reverse Split" — A March 1995 five-to-one reverse unit split. In connection with the Reverse Split, the General Partner's owner, defendant The Hallwood Group Incorporated ("HGI") purchased 30,000 post-Split Units at $11.88 a unit, which was the market-based price tied to the issuance to HGI.

- The "Ontion Plan" — A March 1995 unit option plan that granted 86,000 post-Split units to officers and employees of the General Partner, including HGI's controlling stockholders, defendants Anthony Gumbiner and the late Brian Troup.[1] The 86,000 options constituted 4.7% of the Partnership's equity, and were set at a market-based price tied to the issuance of the units.

- The "Odd Lot Offer" — A June 1995 odd lot tender offer in which the Partnership bought 293,539 post-Split units in blocks of fewer than 100 from June 5, 1995 to July 10, 1995. The Partnership then re-sold these to HGI for $4.1 million, or approximately $14.20 a unit — the identical price that was paid by the Partnership to unitholders which was based on a market price formula. The Odd Lot Offer was exempt from the federal disclosure regulations that govern other tender offers. As a result, the unitholders were provided with no financial information in connection with the offer that they could use to evaluate the fairness of the Offer price.

[1] When this opinion was initially issued, the court assumed, incorrectly, that Troup's estate had been substituted as a defendant. In a later oral ruling on July 30, 2001, the court granted Gotham additional time to substitute Troup's estate.

In the Odd Lot Offer and Reverse Split, HGI increased its holdings of the Partnership from 5.1% to over 24.7%. If the Options granted to its affiliates are included, HGI's control increased to 29.7%. These percentages are important because the "Partnership Agreement" requires a 66% affirmative vote to remove the General Partner.

HGI alleges that these transactions (together, the "Challenged Transactions") were unfair to Partnership unitholders because they permitted HGI to pay an unfairly low price to acquire units that secured its unassailable control over the Partnership. In its complaint, Gotham alleged that the General Partner and its directors breached their fiduciary and contractual duties in effecting the Challenged Transactions.

The fiduciary duty claims against the General Partner were dismissed by an earlier award of summary judgment because the Partnership Agreement's provisions supplanted the traditional default fiduciary duties that applied to the General Partner.* Thus, it was held that the validity of the Challenged Transactions and the liability of the defendants therefor depended on whether the Challenged Transactions were consummated in conformity with the Partnership Agreement.

In this opinion, I conclude that:

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[2] *See Gotham Partners, L.P.. v. Hallwood Realty Partners, L.P.* ("*Gotham S.J. Op.*"), Del. Ch., C.A. No. 15754, mem. op., Shine, V.C. (Sept. 27, 2000).

1) The Odd Lot Offer was consummated in breach of the Partnership Agreement. Because that transaction involved the resale of existing, listed units to HGI, the transaction required approval by the General Partner's Audit Committee and had to be effected on terms no less favorable than could have been procured from a third-party comparable to HGI. The General Partner and its board failed to comply with these contractual requirements.

2) The breach of the Agreement as to the Odd Lot Offer is not excused by any statutory or contractual safe harbor. All of the remaining defendants had a self-interest in ensuring that the transaction was favorable to HGI and the General Partner. Moreover, the defendants cannot take refuge in the Partnership Agreement or advice of counsel because the Agreement provisions that they breached were not ambiguous, they did not carry out the transaction in accordance with the advice they were given, and the advice was given by a conflicted attorney on whom they could not reasonably rely.

3) An award of money damages that approximates a fair price is the appropriate remedy for the defendants' breach. In so concluding, the court rejects Gotham's demand for rescission because such a remedy would be too harsh in light of Gotham's failure to file suit until well after the Odd Lot Offer was consummated.

4) The Reverse Split and Option Plan were conducted in conformity with contractual provisions vesting extremely broad discretion in the General Partner.

I. The Critical Contractual Provisions

The facts of this case are best read in light of the critical contractual dispute between the parties. For its part, Gotham contends that the Challenged Transactions — in particular, the Odd Lot Offer — involved the simple sale of units from the Partnership to HGI. As a result, it asserts that

those Transactions were governed by §§ 7.05, 7.09, and 7.10(a) of the Partnership Agreement. Section 7.05 states that the Partnership "is *expressly permitted to enter into transactions with the General Partner or any affiliate thereofprovided that the terms of any such transaction are substantially equivalent to terms obtainable by the Partnership from a comparable unaffiliated third party.*"[3] Section 7.09 provides in pertinent part that "the General Partner may, on behalf of and for the account of the Partnership, purchase or otherwise acquire Units and following any such purchase or acquisition, may sell or otherwise dispose of such Units. . " Section 7.10(a), meanwhile, states that the General Partner shall "form an Audit Committee . . . comprised of two members of the board of directors who are not affiliated with the General Partner or its Affiliates except by reason of such directorship. . . . *The function[] of the Audit Committee shall be to review and approve. . . transactions between the Partnership and the General Partner and any* of *its Affiliates.*"[4]

The defendants argue that §§ 7.05 and 7.1 O(a) are inapposite to the Challenged Transactions, because each of those transactions supposedly involved the "issuance" of Partnership units to HGI. Issuances, say the

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[3] Emphasis added.

[4] Emphasis added.

defendants, are governed by § 9.01 of the Partnership Agreement, which is inconsistent with the entire fairness approach of §§ 7.05 and 7.10(a). The relevant parts of § 9.01 follow:

> (a) Subject to Sections 9.01(b) and (c) hereof, the General Partner is authorized to cause the Partnership to issue Units at any time or from time to time to the General Partner, to Limited Partners or to other Persons . . . without any consent or approval of the Limited Partners or Assignees. . . . *Subject to Section 9.01 (b) hereof the General Partner shall have sole and complete discretion in determining the rights, powers, preferences and duties and the consideration and terms and conditions with respect to any future issuance of Units . . .*
>
> (b) The General Partner or any Affiliate thereof may, but is not obligated to, make Capital Contributions to the Partnership in the form of cash or other property in exchange for Units. *Except as set forth above, the number of Units issued to the General Partner or any such Affiliate in exchange for any Capital Contribution shall not exceed the Net Agreed Value of the contributedproperty or the amount of cash, as the case may be, divided by the Unit Price of a Unit as of the day of such issuance.*[5]

The defendants claim that the Transactions were in fact carried out as issuances under § 9.01 and that the price paid by HGI complied with the floor set by § 9.01(b) for issuances to affiliates of the General Partner, which is based on a five-day market average tied to the date of issuance. Noting that, subject to this floor price, § 9.01(a) vests "sole and complete"

[5] Partnership Agreement § 9.01 (emphasis added).

discretion in the General Partner to set the terms of issuances, the defendants claim that the plain language of the Partnership Agreement precludes the operation of §§ 7.05 and 7.10(a). In further support of this argument, the defendants note that § 7.10(c) provides:

> Whenever in this Agreement . the General Partner is permitted or required to make a decision (i) *in its "sole discretion" or "discretion" or under a similar grant* of *authority or latitude, the General Partner shall be entitled to consider only such interests andfactors as it desires and shall have no duty or obligation to give any consideration to any interest* of *orfactors affecting the Partnership, . the Limited Partners or the Assignees,* or (ii) in its "good faith" or under another express standard, *the General Partner shall act under such express standard and shall* not *be subject to any other or different standards imposed by this Agreement, . .* or any other agreement contemplated herein or therein. *Each Limited Partner or Assignee hereby agrees that any standard* of *care or duty imposed in this Agreement, .* or any other agreement contemplated herein *or under the Delaware RULPA or any other applicable law, rule or regulation shall be modified, waived or limited in each case as required to permit the General Partner to act under this Agreement, . . .* or any other agreement contemplated herein and to *make any decision pursuant to the authority prescribed in this Section 7.1 O(c) so long as such action or decision does not constitute willful misconduct and is reasonably believed by the General Partner to be consistent with the overall purposes* of *the Partnership.*

To superimpose either the substantive requirement of § 7.05 or the procedural requirement of § 7.10(a) on § 9.01 transactions, the defendants contend, would conflict with the clear mandate of § 7.1 O(c) by fettering the General Partner's complete discretion with conflicting substantive and procedural "standards" and by requiring it to consider "interest[s] of or

D. Do Provisions Of The DRULPA Or The Partnership Agreement Exculpate The Defendants' Breach?

The defendants have asserted certain affirmative defenses that allegedly insulate them from liability. I begin with their reliance on § 17-1101(d)(1) of DRULPA, which states in pertinent part that:

> To the extent that, at law or in equity, a partner or other person has duties (including fiduciary duties) and liabilities relating thereto to a limited partnership or to another partner . . . (1) any such partner or other person acting under the partnership agreement shall not be liable to the limited partnership or to any such other partner . . for the partner's or other person's good faith reliance on the provisions of the partnership agreement. . .[35]

The parties vigorously contest the meaning of § 17-1101(d)(1). For their part, the defendants view the statute as immunizing any breach of a partnership agreement, so long as the breach resulted from a good faith misreading of even an unambiguous provision. According to the defendants: (i) § 17-1101(d)(2) of DRULPA allows a Partnership Agreement to occupy the territory covered by traditional fiduciary duties by specifying the standards that will replace such duties, thus creating a safe-harbor from

[35] 6 Del. C. § 17-1101(d)(1).

Challenged Transactions.[46] Kailer could not give objective, independent advice to the Partnership. Gumbiner, Troup, and Guzzetti should have known that, and the non-HGI directors appear not to have had knowledge of Kailer's contemporaneous service as HGI's legal counsel.

E. Are The Defendants Other Than The General Partner Responsible For The Contractual Breaches?

The defendants other than the General Partner raise an interesting defense. In a previous opinion, I held that the General Partner's fiduciary duties were supplanted by the contractual regime and that its liability would hinge solely on the Agreement. As a result, the defendants argue that the HGI directors and HGI itself cannot held liable for breach of fiduciary duty either, and that they cannot be held liable under contract law because there is no such thing as a claim for aiding and abetting a breach of contract.[47]

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[46] Texas Rules of Prof' 1 Conduct R. 1.06 (b), (c); see also Charles W. Wolfram, *Modern Legal* Ethics § 7.3.4 (1996) (representing seller and buyer simultaneously is a conflict and stating that a "conflict exists if any common material interest of different clients diverge in a significant way"); *Williams v. Reed, 3* Mason 405,418, Fed. Case No. 17,733 (CC Maine 1824) ("When a client employs an attorney, he has a right to presume, if the latter be silent on the point, that he has no engagements, which interfere, in any degree, with his exclusive devotion to the cause confided to him; that he has no interest, which may betray his judgment, or endanger his fidelity") *(quoted with approval in International Bus. Machines Corp. v. Levin, 579* F.2d 271,282 n.3 (3d Cir. 1978).

[47] In this respect, I note that the defendants' argument is inconsistent with the approach taken by this court in *Fitzgerald v. Cantor,* C.A. No. 16297.NC, 1999 WL 182573, at *1, Steele, V.C. (Mar. 25, 1999) (where partnership agreement provided the definition of the general partner's fiduciary duties, an aiding and abetting claim still existed against other defendants who facilitated a breach of those duties, because the origin of the fiduciary duties was not critical to the purpose served by the cause of action).