IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE 99

IN AND FOR NEW CASTLE COUNTY

STEPHEN A. COLE, Plaintiff, v. KENNETH A. KERSHAW, ALLEN C. LIDDICOAT, ELIZABETH E. ROBBINS, R. BRUCE WHITE and RICHARD C. WOODIN, CHURCHTOWN PARTNERS and B.A.R..K.E., L.L.C., Defendants.	Civil Action No. 13904

MEMORANDUM OPINION

Date Submitted: February 3, 2000
Date Decided: August 15.2000

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JACOBS, VICE CHANCELLOR

The plaintiff, Stephen Cole, who was a former partner of Churchtown Partners, a Delaware general partnership ("Churchtown" or "the Partnership"), challenges the October 1, 1993 merger of Churchtown into BARKE, LLC, a Delaware limited liability company formed and owned by the defendants, who were Churchtown's remaining partners ("BARKE"). In the merger, which eliminated Cole's interest in the Partnership, Cole received a cash payment of $2,000. Cole attacks the merger on two grounds: (i) the merger was not legally authorized under either the Delaware Partnership Act or the Partnership Agreement, and (ii) even if the merger was legally valid, it was equitably invalid because lboth the decision-making process leading up to the merger and the $2,000 merger price were unfair. By virtue of these claimed breaches of fiduciary duty by the defendants, Cole seeks an award against them of damages plus his attorneys' fees and expenses.

This is the Opinion of the Court, after trial and post-trial briefing, on the merits of these claims. For the reasons next discussed, I conclude that although the merger was statutorily valid, its terms were unfair to Cole. Consequently, the plaintiff has established his entitlement to relief, which will be an award of damages measured by the value of Cole's partnership interest as of the date of the merger, subject to adjustments to reflect the disproportionate risk and expense that

Cole's pre-merger conduct inflicted upon the defendants.

I. THE FACTS[1]

The plaintiff, Cole, and the individual defendants (Elizabeth Robbins, R. Bruce White, Allen C. Liddicoat, Kenneth Kershaw, and Richard Woodin) were all partners of Churchtown. The corporate defendant, BARKE, was the vehicle created to effectuate the merger and to operate Churchtown's business under a different entity form owned by Churchtown's former partners other than Cole.

A. The Formation of Churchtown

In November 1989, Cole and the individual defendants formed Churchtown as a Delaware general partnership, to purchase and develop a 400+ acre parcel of raw farmland located south of the Chesapeake & Delaware Canal in New Castle County, Delaware (the "Property"). The partners' plan was to develop the Property into a golf-course residential community by building a golf course, installing the subdivision's infrastructure, and then selling the individual lots to third-party residential builders (the "Project").

[1]Many of the underlying facts are undisputed, but where there are disputes, the facts are as found herein.

As envisioned, the Project would have been the largest residential subdivision south of the C&D Canal at that time.[2] In the real estate world, that kind of project was considered a very high-risk type of real estate development.[3] The Project's "normal" risks were compounded by the fact that the Property was highly leveraged: $1.8 million of the $1.925 million purchase price had been financed by a loan from Wilmington Trust Company (the "Loan") that would fall due in three years.[4]

In forming Churchtown, the partners executed a "standard form" general partnership agreement to formalize their legal arrangement. The Partnership Agreement called for an initial capitalization of $400, allocated as follows: Robbins and White -- $100 each, and Liddicoat, Kershaw, Cole and Woodin -- $50 each. The Partnership Agreement did not explicitly address how the Partnership would be funded thereafter on an ongoing basis, but the partners all understood and agreed that that would be done through a combination of periodic "cash calls" and a bank loan promissory note personally signed by each partner.[5]

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[2]Tr. at 450.

[3]Tr. at 274.

[4]DX 2, 3.

[5]Tr. at 66-67, 85; 446; DX 3, 5, 9, 12, 15, 19, 22, 24, 29, 34, 37, 40, 44.

The “cash calls” would be made as needed to fund the Project through its various stages to completion. Importantly for present purposes, the Partnership Agreement did not prescribe what the consequences would be if a partner failed to meet a cash call for additional capital contributions -- the precise contingency that occurred in this case.

B. The Partnership’s Initial Financing

On November 1, I. 989, the Partnership borrowed $1,800,000 from Wilmington Trust Company to finance the purchase of the Property (the “Loan”). Each partner and his or her spouse became personally liable on the Loan promissory note, which would fall due on November 1, 1992. From November 1989 until September 199 1, Cole was fully involved in and knowledgeable of the Partnership activities, and up to September 1991, he paid his share of all cash calls on a current basis. For that 22-month period, Cole’s cash contributions to Churchtown totaled $84,496.[6]

Beginning with the September 1991 cash call, however, Cole stopped meeting his financial obligations to the Partnership. Cole also stopped communicating with his partners, and never responded to any of their efforts to

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[6]Tr. at 9, 65-67, 69-70; DX 122.

communicate with him. Cole did not inform his partners that he no longer intended to meet cash calls, nor did he tell them the reasons why. Cole's explanation at trial was that he needed to devote his financial resources to prosecuting and defending other lawsuits that concerned other business ventures, some of which involved one or more of the defendants.[7] Cole further explained that he expected his partners in Churchtown to give him "some latitude" in meeting cash calls, as he claimed to have done in similar circumstances involving certain of the defendants.*

C. Refinancing of the Loan

From its inception, the Project experienced constant setbacks in obtaining regulatory approval for the Record Plan for the proposed subdivision. The Project also faced burdensome challenges from the Delaware Department of Transportation ("DelDOT") and the Water Resources Agency.' Those setbacks

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[7]Tr. 84; DX 44.

[8]Cole Dep. at 93; Cole admitted, however, that at no time did he ever "carry" Liddicoat, Robbins, or White -- who collectively owned 62.5% of the Partnership.

[9]New legislation that had been enacted in the summer of 1990 tightened the regulatory requirements related to "spray irrigation" -- the type of wastewater management on which the Project was based. Those requirements restricted the number of available lots on the subdivision. Related problems stemmed from the fact that the Property was located within a Water Resource Protection Area, which raised various environmental and water quality issues. DelDOT also expressed concern that the rural roadways surrounding the Property would not be able to handle the increased traffic flow that would result from development. These concerns required special

created the need for additional financing in order for the Project to continue. Those increased financial demands, coupled with the fact that the Loan would soon fall due,[10] imposed significant economic pressure on the Partnership. Indeed, it quickly became clear that the Partnership could avoid foreclosure only by refinancing the Loan. Accordingly, Mr. Liddicoat contacted Mr. Charles Brown, the Partnership's loan officer at Wilmington Trust, in an effort to obtain refinancing. Wilmington Trust agreed to refinance the Loan, on the conditio-n that all of the partners personally become obligors on the promissory note. In December 1992, Mr. Brown sent to Mr. Liddicoat the necessary refinance loan documents, to be executed by all the partners."

It was at this point that the partners first learned that they had a problem with Mr.. Cole. The parties, each of whom had executed the original Loan documents, received telephone messages from Mr. Liddicoat's secretary, requesting them to come to Liddicoat's office to execute the loan refinance

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studies to be performed, which created additional expense for the Partnership and further delayed the completion of the Project.

[10]DX 84; Tr. at 5 11.

[11]Tr. at 515.

documents.[12] All of them did that except Cole,[13] who claims that he did not receive that telephone call, that he was never asked to sign these documents, and that the defendants never told him that the Partnership was in serious jeopardy. The heavy weight of the credible evidence, however, proves the contrary. In fact, telephone calls were made (without success) to Cole, and a message was left with his secretary.[14] Althoug'h Cole did not appear or execute the refinance loan papers, Mr. Liddicoat continued his efforts to contact Cole and to inform him that the refinancing papers needed to be signed. Cole, however, remained unresponsive. Liddicoat then informed his partners of Cole's refusal to respond to his efforts to contact him. The defendants became quite concerned that something needed to be done to enable the Project to be refinanced and to move forward.[15] Ultimately, the defendants prevailed on Wilmington Trust to refinance the Loan on this one occasion without Cole's participation. Wilmington Trust informed the defendants, however, that any future: loans would have to be signed by all the partners.[16]

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[12]Tr. at 515.

[13]DX 82.

[14]Id.

[15]Tr. at 522-23.

[16]Tr. at 555-56.

C. The Defendants Merge Churchtown into BARKE

Ultimately the defendants concluded that Cole's abdication of his responsibility to them, coupled with Wilmington Trust's stated refusal to extend further credit without Cole's participation, left only one workable solution: eliminate Cole as a partner. The defendants sought legal advice about how to accompl-ish that.[17] The result was the August 1993 Plan and Agreement of Merger between Churchtown Partners and BARKE, which (to repeat) was a limited liability company ("LLC") that the defendants created as the vehicle to eliminate Cole's Partnership interest.[18] Under that Agreement, Churchtown was merged into BARKE, whose members (owners) were all of the Churchtown partners except Cole -- i.e., the individual defendants. The consideration paid to Cole in the merger was a cash payment of $2,000, which was the amount the individual defendants had unilaterally determined as the value of Cole's partnership interest. The defendants made that determination without the benefit of any independent or expert financial advice concerning the value of the Partnership. The merger became effective on October 1, 1993, when a Certificate of Merger was filed with

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[17]Tr. at 338, 523, 559.

[18]PX 27-28.

the Delaware Secretary of State.[19]

At the time of the merger, an agreement to develop the subdivision (the "Corrozzi agreement")[20] was in place, and record plan approval for the subdivision had been obtained.[21] Formal approval for the golf course had not yet been obtained, although the necessary zoning variance had been secured.[22]

Cole was never told that his partnership interest either would be -- or bad been -- eliminated by the merger. Nor did Cole learn that until nine months later when he received a copy of Churchtown's IRS Form K-l on June 28, 1994.[23] That was the first notice that Cole received of the merger and of the resulting elimination of his 12.5% Partnership interest.[24] At that time Cole also received the $2,000 payment for his 12.5% interest. Importantly, the value of Cole's Partnership interest had not been determined as of October 1993, the merger effective: date. Rather, it had been valued as of September 199 1 -- two years

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[19]PX 76.

[20]Corrozzi Properties was the only builder who at that time had showed interest in the Project. The resulting contract obligated Corrozzi to purchase five lots. Tr. at 524, 597.

[21]PX 40, PX 81-82.

[22]Woodin Dep. at 362 & 364.

[23]Cole Dep. at 18; PX 88E at 604.

[24]Cole Dep. at 17-18.

earlier, when Cole stopped making his cash call payments.

II. THE CONTENTIONS

Cole asserts two claims for relief. The first is that the merger was legally invalid because neither the then-applicable partnership statute nor the Partnership Agreement authorized a merger of a general partnership into an LLC. As a consequence, Cole urges, the Partnership still exists, he remains a partner, and his damages, measured as the fair value of his Partnership interest, must be determined as of the date of trial.

Second, and in the alternative, Cole contends that even if the merger was valid legally, it was invalid equitably because the merger was not entirely fair and was therefore the product of a breach of fiduciary duty owed by the defendants to Cole. All parties agree that the defendants stood on both sides of the merger transaction and that the (entire fairness standard of review is applicable. The plaintiff argues that under that standard the defendants cannot satisfy their burden to prove that the merger was entirely fair to Cole, because neither the decision-making process nor the transaction price was fair.

The defendants assert several defenses against these claims. First, they argue that Cole comes to this Court with unclean hands and is therefore barred from seeking relief. Second, they contend that at the time of the merger Cole was no longer a partner of Churchtown, and therefore was not entitled to be paid -the fair value of his interest at the time of the merger. Third, the defendants urge that even if the unclean hands defense does not apply and Cole was a partner at the time of the merger, (1) the merger was valid legally because the then-applicable LLC statute authorized a merger of an LLC and a general partnership, and (2) the merger was valid equitalbly because it was entirely fair in terms of both process and price. Therefore, defendants conclude, the merger lawfully terminated the Partnership under the terms of the Partnership Agreement, and Cole was paid all that he was entitled to receive.

These contentions raise five issues. (1) Does the unclean hands doctrine bar the plaintiffs claims? (2) Was Cole a partner of Churchtown at the time of the merger? (3) Was the merger of Churchtown into BARKE valid as a matter of Delaware statutory law? (4) Have the defendants carried their burden of showing that the merger was entirely fair? Because I conclude that the plaintiff prevails on these four issues, a fifth issue arises, which is: how should damages be determined? These issues are now addressed.

III. LEGAL ANALYSIS

A. The Affirmative Defenses

I first consider the affirmative defenses because, if accepted, they would obviate the need to determine the "merger validity" issues.

1. The Unclean Hands Defense

The defendants argue that Cole is guilty of unclean hands because he violated his duties to the Partnership, and thereby created the need for the very merger he now attacks, which was necessary to assure that the Project could survive. The defendants claim that because Cole's failure to meet cash calls and to execute the loan refinance agreements jeopardized the Partnership's ability to survive, "the doors to the Court of Equity should be shut against [Cole]," who comes to this Court with unclean hands.[25]

I cannot agree. Although Cole did violate his obligation to meet the cash calls and. sign the loan refinance documents, that is not sufficient to bar him from seeking relief in equity. Nowhere did the Partnership Agreement specify that the consequence of a partner's failure to make cash calls would be the outright forfeiture of his or her Partnership interest. To validate that defense would give Cole's other partners license to treat him however unfairly they chose, without Cole having any legal recourse. That inequitable result would be a perverse application of the defense of unclean hands, which itself is a doctrine intended to

[25]Citing Bodlev v. Jones, Del. Supr., 59 A.2d 463, 465 (1947); see also Nakahara v. NS 1991 American Trust, Del. Ch., 718 A.2d 518, 522 (1998).

accomplish equity. Where (as here) the Partnership Agreement does not address this nonpayment issue, to utilize that doctrine to till that gap would be unduly harsh. To be sure, Cole should have to pay a price for his irresponsible abdications. But in these circumstances the forfeiture of his Partnership Interest would be too high a price.

Accordingly, the unclean hands defense must be rejected.[26]

2. The Argument That Cole Ceased Being a Partner in 1991-92

The defendants next contend that Cole was not a partner at the time of the merger, because during the 1991-1992 period, his conduct either (i) constituted an abandonment of the Partnership, or (ii) operated legally as a dissolution of the Partnership.

The abandonment argument is said to rest upon Pan American Trade and Investment Corporation,[27] where this Court found that no abandonment had occurred. Defendants urge, despite that result, that the analysis employed in Pan American would compel an opposite finding in this case. The defendants point to the Pan American Court's pronouncement that "[t]he relationship between, . .

[26]As discussed elsewhere in this Opinion, Cole's abdication of responsibility will be accounted for as a downward adjustment to the damages to be awarded.

[27]Del. Ch., 154 A.2d 151 (1959).

partners, is fiduciary in character and imposes on all participants the utmost good faith, fairness, and honesty in dealing with each other" in connection with their venture;[28] and its finding that there had been no abandonment because the record "clearly sustain[ed] a finding that [plaintiff] performed his part of the bargain" and clearly established that "[plaintiff] did not at any time discontinue his efforts" in connection with the venture.[29] Here by way of contrast (the defendants argue), Cole's failure to meet cash calls, to communicate with his partners, and to sign the loan refinance documents, establish that he did not "perform[] his part of the bargain," and that he had "discontinue[d] his efforts" in connection with the venture.

Alternatively, the defendants argue that even if Cole's conduct did not constitute an abandonment, it did operate as a dissolution of the Partnership. The argument runs as follows: the partnership statute defines dissolution as a "change in relation of the partners caused by any partner ceasing to be associated in the carrying on. . .of the business."[30] Dissolution results from the express will of any partner at any time, whether stated directly or implied from conduct indicating that

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[28] Id. at 154 (citations omitted).

[29] Id. at 155.

[30] 6 Del. C. § 1529.

partner's, abandonment of the partnership.[31] The defendants contend that Cole's failure to make cash calls, to communicate with his partners, and to sign the refinance loan documents epitomized the "change in relation" that either automatically worked a dissolution of the Partnership under 6 Del. C. § 153 1, or at the very least, justifies a decree that the Partnership was dissolved at the time this conduct occurred.[32]

Neither argument, in my opinion, has merit. Both positions are flatly inconsistent with the defendants' professed rationale for eliminating Cole from the venture, which is that Cole was a partner, and that the remaining partners had no choice but to eliminate Cole as a partner if the Partnership was to obtain the financing needed for its survival. The record, moreover, is devoid of any evidence that at any time before the merger or before this litigation was commenced, the defendants ever took the position that Cole had abandoned the Partnership or that

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[31]6 Del. C. § 1531(2); See also 1 Rowley on Partnership § 31.2 (2d ed.).

[32]The Delaware partnership statute, 6 Del. C. §§ 1532(a)(3)(4)(6), pertinently provides that the Court "shall decree a dissolution" whenever one partner:

> "(a) has been guilty of such conduct as tends to prejudicially affect the carrying on of the partnership's business;
> (b) willfully or persistently commits a breach of the parties' agreement or conducts himself in matters relating to the partnership so that it is not reasonably practicable to carry on the business in partnership with him; or
> (c) otherwise acts in such a way that renders dissolution equitable under the circumstances."

his conduct had caused its dissolution. Accordingly, these counterfactual arguments have the earmarks of a litigation-driven contrivance.

Moreover, those contentions, in these circumstances, are inequitable. There is no evidence that the defendants ever informed Cole of their legal position or that they intended to eliminate his interest in the Partnership. I do not doubt that the defendants reasonably believed that Cole had abandoned the Partnership or that the defendants were acting in good faith. But the defendants' benign mental state cannot justify their eliminating Cole as a partner without affording him prior notice and an opportunity to protect his interests.

The Court's rejection of these threshold defenses brings to the forefront the substantive merger validlity issues, which are next evaluated.

B. The Statutory Validity of the Merger

The plaintiff first attacks the statutory validity of the merger, on the basis that neitlher the Partnership Agreement nor the general partnership statute authorized a merger between an LLC and a general partnership. Cole acknowledges that § 209 of the Delaware Limited Liability Company Act, which was then in force, did permit an LLC to merge with a partnership. He argues, however, that the fact that LLCs could legally merge with partnerships does not establish the converse, i.e., that partnerships were legally authorized to merge with

LLCs.

Alternatively, Cole argues that even if $209 is read to authorize the Partnership to merge with BARKE, that provision should not be applied here because the Partnership was formed before the LLC statute was enacted, and therefore the application of $209 to this merger would be impermissibly retroactive. Finally, Cole contends that in any event, the merger did not dissolve the Partnership, because it did not effect a dissolution under either the Delaware Uniform Partnership Law ("DUPL") or the Partnership Agreement.

I cannot accept these arguments. Although neither the Partnership Agreement nor the DUPL contained a provision expressly authorizing mergers of general partnerships with other entities, that does not end the analysis. The DUPL directed that "[i]n any case not provided for in this chapter the rules of law and equity. . . shall govern."[33] One of those "rules of law" was Section 209 of Delaware's then-applicable LLC statute, which expressly authorized a merger of a Delaware LLC into a partnership:

> Pursuant to an agreement of merger or consolidation, a domestic limited liability company may merge or consolidate with or into 1 or more domestic limited liability companies or other business entities formed or

[33] 6 Del. C. § 1505.

> organized under the law as of the State of Delaware or any other state of the United States or any foreign country or other foreign jurisdiction, with such domestic limited liability company or other business entity as the agreements shall provide being the surviving or resulting domestic limited liability company or other business entity.
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> As used in this section, "other business entity" means a corporation, or a business trust or association, a real estate investment trust, a common law trust, or any other unincorporated business, including a partnership (whether general or limited), and a foreign limited liability company, but excluding a domestic limited liability company.[34]

If this provision, explicitly authorizing LLCs to merge with general partnerships, is to have meaning, the General Assembly must be presumed to have intended that such a merger could go in either direction, i.e., that LLCs would be allowed to merge with general partnerships, or the reverse. Therefore, the fact that the general partnership statute was silent on the subject is of no moment. The LLC statute was not silent, and, accordingly, authorized the merger.

Cole next contends that because Churchtown was formed before the LLC statute became effective in 1992, applying that statute to this merger would constitute an impermissible retroactive application. This argument is unfounded, because nothing in the LLC statute limits its applicability to merging entities that

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[34] 6 Del. C. §§ 18-209 (a)-(b).

were formed after the statute was enacted.[35] Accordingly, the relevant time for applying the statute is the date of the merger, not the earlier date on which the Partnership was formed.[36] The merger here occurred on October 1, 1993, after the statute had become effective, for which reason the application of the LLC statute is prospective, not retroactive.

I further conclude (contrary to Cole's position) that the effect of the merger was to dissolve Churchtown. To dissolve a general partnership, the DUPL required either the "express will of all the partners" or that a dissolution by expulsion of a partner be "in accordance with such powers conferred by agreement."[37] In this case, the relevant "powers conferred by agreement" are found in Section 17 (a) (iii) of the Partnership Agreement, which provided that:

> The Partnership is dissolved bv operation of law, other than by reason of the bankruptcy, incompetency, death, dissolution, termination or withdrawal of any Partner where the business of the Partnership is carried on without termination or winding up as provided. . .(emphasis added)

Here, the merger operated as a dissolution by "operation of law," because as a

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[35]See 6 Del. C. §§ 18-209; compare with 6 Del. C. §2301(a) (expressly restricting application to certain dates of occurrence.)

[36]See id.

[37]6 Del. C. § 1531.

result, the Partnership ceased to exist and its assets and liabilities passed to BARKE as the surviving entity.[38] Therefore, the dissolution of Churchtown was "in accordance with such powers conferred by agreement" within the meaning of 6 Del. C. § 1531.

The statutory validity and the legal effect of the merger having been determined, I now turn to the plaintiffs equitable validity claim, i.e., that the merger was not entirely fair to Cole.

C. The Equitable Validity of the Merger

All parties agree that entire fairness is the applicable standard of review,[39] and that under that standlard the defendants have "the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts."[40] Entire fairness has two components: fair dealing and fair price.[41] Fair dealing "embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the

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[38]Churchtown Partnership Agreement, Section 17 (a) (iii).

[39]Def. Ans. Br. at 29.

[40]See Weinbereer v. UOP, Inc., Del. Supr., 457 A.2d 701,710 (1983).

[41]See id. at 711.

directors, and the stockholders were obtained."[42] Fair price "relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock."[43]

1. Fair Dealing

The defendants contend that even though their merger decision making process was imperfect, it should not be found unfair. The reason (defendants say) is that Cole's conduct was so egregious that he should not be entitled to the same level of fair treatment that would be required in different circumstances.[44] More specifically, defendants insist, Churchtown was a privately-held nearly insolvent partnership, and the types of procedural safeguards normally required in mergers of large publicly held corporations should not be mandated in this quite different setting. Based on this premise, the defendants freely concede that while Cole did

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[42] Id.

[43] Id.

[44] As defendants argue in their Answering Brief (at page 29): "What is "fair depends entirely on the circumstances and what is "entirely fair" is -- if possible -- even more bound to the "entire" factual context. . . .For two years, Mr. Cole refused to live up to his obligations, refused to communicate, and left his partners in the lurch. He had, in fact, betrayed their trust and breached his duties to them. The defendants were therefore clearly entitled to deal with the problems Mr. Cole's conduct was causing and was likely to cause in the future." The defendants' arguments beg the issue, however, which is not whether they were entitled to deal with those problems, but how.

not receive advance notice of the merger, that process failure should be regarded as "immaterial" and as "a detail that simply did not get done."[45]

The argument does not withstand scrutiny. Procedures designed to ensure fair process in the context of small enterprises may indeed differ (within limits) from those required in the context of larger corporations. But certain "fair process" procedures are fundamental and cannot be dispensed with. One of them is advance notice of a transaction that may be adverse to a partner's interests.[46] Here, Cole did not receive notice of the merger and its elimination of his partnership interest until almost nine months after the merger became effective.[47] That failure to provide adequate and timely notice deprived Cole of any opportunity to seek injunctive relief or otherwise to protect his interest, such as (for example) by negotiating (either directly or through counsel) better merger terms. The second -- and in this case, fatal -- process failure was that the val-uation

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[45]Id. at 30.

[46]See Kumar v. Racing Corp. of America, Inc., Del. Ch., C.A. No. 12039, Mem. Op. at 12, Berger, V.C. (Apr. 26, 1991) ("Although the procedures followed in the merger of a small corporation may not normally be as elaborate as those followed by larger companies, fair dealing is still required. Here, there seems to have been no effort to negotiate with anyone on behalf of the public minority stockholders or plaintiffs. Beyond the absence of negotiations, it appears that there was a deliberate effort to keep plaintiffs in the dark and thereby prevent them from protecting their rights. How else can one explain the failure to give Kumar, a large stockholder and a director, any notice of the proposed merger. . .")

[47]Cole Dep. at 17-18.

of Cole's partnership interest was accomplished unilaterally by self-interested parties (the individual defendants), unaided by any independent or disinterested valuation advice.

Accordingly, the defendants have failed to establish that the merger was the product of fair dealing.

2. Fair Price

The defendants paid Cole $2,000 based on their unilateral valuation of his 12.5% partnership interest as of 1991, the year Cole ceased making cash call payments. The defendants argue that $2,000 represented the "fair price" for Cole's partnership interest. They are wrong.

The basis for $2,000 payment was a 1991 valuation of the Partnership's land, not; a valuation made as of the October 1993 merger date. It is undisputed that the value of the Partnership's assets as of the merger date was considerably greater than its value two years earlier. The 199 1 value was based on an appraisal of the raw land at historical cost,[48] with no worth ascribed to its future earning capacity, But by 1993, Churchtown had become a viable enterprise that had substantial going concern value, the source of which was not limited to raw land.

[48]PX 43.

That value also derived from Churchtown's contractual arrangements with Corrozzi and from the development value of the subdivision that had recently received approval.[49] Under no circumstances could the $2,000 payment have represented the "fair price" to which Cole was entitled as compensation for the surreptitious appropriation of his Partnership interest.

Because I conclude that the defendants have not met their burden to demonstrate that the merger was entirely fair either as to process or price, Cole is entitled to a remedy. I find the appropriate remedy to be an award of damages measured by Cole's proportionate share of the fair value of the Partnership, calculated as of the October 1, 1993 merger date. How that award is to be determined is the issue next discussed.

D. The Appropriate Damage Award

The final issue is the amount of damages to which Cole is entitled. The Court has determined that the merger effected a dissolution of the Partnership on October 1, 1993 and that Cole remained a Churchtown partner until that time. It therefore follows that Cole is entitled to his proportionate share (12.5%) of the

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[49] PX 40, 81-82.

Partnerslhip's net worth as of October 1, 1993,[50] adjusted downwards to account for the incremental risk Cole inflicted upon the remaining partners by his refusal to pay the cash calls and to execute the loan refinancing documents. The contested evidence of these values is now analyzed.

1. The Value of the Partnership's Assets as of October 1993

As of October 1, 1993, the Partnership's assets consisted of 201 residential lots, plus approximately 240 acres that were set aside to build the golf course ("the Project"). The question is: what was the fair market value of the 201 lots and the golf course as of that date? In an effort to address that issue, each side engaged an expert to value the Project as of October 1, 1993 and earlier dates, and to testify at trial on those subjects.

a. The Value of the 201 Lots

Respecting the value of the 201 lots, the parties dispute which valuation method -- the discounted cash flow method ("DCF") or the Sales Comparison

[50]The Partnership's net worth is the fair market value of the Partnership's assets at that time, less the Partnership's liabilities. See Churchtown Partnership Agreement Section 16 (b) which provides that: ". . . [the] Partnership interest under this Section 16 shall be an amount determined as of the end of the latest fiscal quarter of the Partnership immediately preceding the Event of Withdrawal equal to the percentage of the fair market value of the net assets of the Partnership which is the same as the percentage of the Withdrawing Partner's interest in the profits and losses of the Partnership."

Approach ("SCA") -- is the more appropriate. The plaintiffs expert, Mr. David Wilk, relied primarily on the DCF method to value the lots, although he did use the SCA as well. Mr. Wilk concluded that the value of each lot was $13,500, yielding a total value of $2,713,500 (201 x $13,500). The defendants' expert, Mr. Thomas Mummaw, relied solely upon the SCA to arrive at his valuation of $8,000 per lot, for a total of $1,608,000.

The defendants challenge Mr. Wilk's reliance on the DCF approach, arguing that it is inappropriate in this case because as of October 1993, little progress had been made on the Project and reliable information that was critical to any DCF analysis was not available at that time. I agree.

The underlying conceptual premise of the DCF valuation method is that the value of the property being appraised is the worth of its future benefits, measured by the present value of its future cash flow.[51] To value the lots under the DCF method, the following information was required: comparable rental data, market vacancy rates, operating expenses, holding costs, and the anticipated yield requirements of investors for the class and type of property being valued.[52] Because as of October 1993 all that existed was raw unimproved land, that

[51] PX126 at 8.

[52] DX 133 at 38; Tr. at 658.

information was not available, and as a result Mr. Wilk's use of the DCF method required him to make assumptions that were speculative and unreliable.[53] I conclude, for those reasons, and in these specific circumstances, that the DCF method was not the most appropriate or reliable of the available valuation approaches.

Of the two valuati.on methods utilized, the SCA is the more reliable. That approach requires ascertaining what it would cost to acquire, without undue delay, a parcel of property comparable to the property being valued.[54] The SCA approach requires that comparable properties be identified and that the sale price of those properties then be adjusted for significant differences between the subject property and the cornparables.

Both experts valued the 201 lots using the SCA. As earlier noted, the plaintiff's expert, Mr. Wilk, valued the 201 lots at $13,500 per lot, for a total of $2,713,500, while the defendants' expert, Mr. Mummaw, valued the lots at $8,000

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[53]For example, in selecting the site development costs, Mr. Wilk relied entirely upon Mr. Cole's estimation of those costs (Tr. at 261-62), which was only one third of the actual expenses (DX 123) and only one half of the estimate for costs made by the partners at the outset of construction (PX 45 at 5). These costs were not increased for inflation, although Mr. Wilk used an inflation factor to account for increases in the lot prices (Tr. at 262). Moreover, he spread the costs evenly over a 10-year period, even though at trial he admitted that a large portion of the site costs for a real-estate project are incurred up front (Tr. at 262-63).

[54]Id.

per lot, for a total of $1,608,000. After considering the experts' reports, the testimony, and the argurnents relating thereto, I conclude that Mr. Mummaw's valuation more reliably represents the, fair value of the 20 1 lots at the time of the merger. Mr. Wilk's valuation analysis is less reliable and persuasive, both because of the comparable properties he selected and the price adjustments he made to those properties.

Mr. Wilk selected as cornparables five properties that had been sold between February 1992 and July 1994. All five properties had been approved for subdivision development, and like the subject Property, had not yet been improved with any new construction, In performing his valuation, however, Mr. Wilk made errors. First, he assumed the 201 lots comprised, all told, 70 acres, whereas in fact they occupied almost 2 11 acres.[55] Mr. Wilk conceded that larger parcels are worth less per lot, but made no adjustment to account for that fact.[56]

Mr. Wilk also erred in adjusting his comparables. Of his five cornparables, only two -- Sale Number 2 and Sale Number 3 -- had per lot prices (before adjustments) above Wilk's $13,500 per lot price. At trial Mr. Wilk admitted that

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[55]Tr. at 235. Because of that incorrect assumption, the 201 lots being valued had far greater acreage than did the comparable properties. Tr. at 235 (the comparables were between 41 and 83 acres in size).

[56]Tr. at 253.

Sale Number 2 was not a good comparable, and also conceded that Sale number 3 was not a good comparable either.[57] Thus, by his own admission, the two sales used to establish the upper end of the value range of Mr. Wilk's cornparables were flawed. Accordingly, I conclude that Mr. Wilk's $13,500 per lot valuation is artificially high.

The defendants' expert, Mr. Mummaw, used three cornparables to arrive at his valuation of the lots. The plaintiff attacks only Mr. Mummaw's experience, stressing that he had never appraised a major residential subdivision in Delaware.[58] Plaintiff does not, however, challenge the substance of Mr. Mummaw's valuation, including the selection of comparable properties or his price adjustments to those cornparables. I find that inexperience alone is not sufficient to discredit an expert absent evidence that the inexperience affected his valuation. Because no such evidence was presented, I accept Mr. Mummaw's $1,608,000 valuation of the 201 lots.

h. The Value of the Golf Course

With respect to the golf course parcel, the basic dispute concerns whether

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[57] Tr at 238. ("Unfortunately, as I discovered in deposition, sale number 3 was not a good comparable...")

[58] Pl. Reply Br. at 26.

that parcel should be valued as if it were approved or unapproved. The undisputed facts are that official approval had not been obtained as of October 1993; however, the land had received a zoning variance, and all that remained was for the Partnership to actually submit a golf course record plan to the County.

The defendants take the position that because the golf course had not been approved as of the October 1993 merger date, and because it was oddly shaped, that parcel had a low value because it would be extremely difficult to develop. The defendants argue that the golf course land was, "a winding tract between. the lots at Back Creek, with a shape that somewhat resembles a flattened squid."[59] Because of its shape and the legal restrictions on the Property, defendants say, the practical difficulties facing anyone who wanted to build on that parcel would have been far greater than for the parcels Mr. Wilk used as his cornparables.

The plaintiff, on the other hand, portrays the golf course land as having been virtually approved. He emphasizes the substantial evidence that the land would not be used for anything other than a golf course and that it had already been granted a variance for that use.

Neither analysis portrays the complete reality of what eventually would

[59]Def. Post-trial Br. at 40.

become the golf course property. The plaintiffs position -- which assumes that the parcel had already received approval -- is too generous, while the defendants' view -- that the property was too difficult to develop as a golf course -- is overly conservative. In reality, as of October 1993, what was to become the eventual golf course property had been all but formally approved. For that reason, I conclude that a fair valuation (like "the truth") lies somewhere in between the parties' valuation positions. Mr. Wilk valued the approximately 237 acres that were earmarked for development as an 1 S-hole golf course, at $6,000 per acre. M-r. Mummaw valued the land at $4,000 per acre. In my view, the more likely fair value of the golf course property as of October 1993 is "in between" -- $5,000 per acre. I tlherefore determine $5,000 per acre as the value of the golf course parcel, for a total value of $1 ,200,000.[60]

2. Adjustments

My findings that as of October 1, 1993 the 201 lots were worth $8,000 per lot, and that the (eventual) golf course property was worth $5,000 per acre, do not conclude the damages analysis. Two further deductions are needed before Cole's damages can be determined: (1) the Partnership's debts and expenses as of

[60]This total assumes that the golf course occupied 240 acres.

October 1993, and (2) an amount attributable to Cole's failure to meet cash calls and to sign the loan refinancing documents. Because the record is not sufficiently developed or clear as to what the Partnership's debts and expenses were of October 1993, I request that the parties submit to the Court supplemental memoranda addressing this point. The memoranda shall also address the appropriate rate of interest that should be added to the amount of Cole's unpaid cash calls.

Moreover, a further, separate adjustment must be made to the damages award to account for Cole's failure to meet the cash calls between 1991 and October 1993, and for the risks and expenses of the Partnership being borne entirely by the other partners. Without an adjustment to reflect that fact, Cole would receive a larger *pro* rata share of the value of Churchtown's assets than what (in my view) would be fair.

Not surprisingly, the parties cannot agree on how to determine that adjustment. Mr. Cole urges that he should be permitted to pay all of the $62,370 unpaid post- 199 1 cash call payments now, and that that amount should be deducted from his damage award. Cole does not propose adding any interest to that deducted amount, even though most of it has gone unpaid for over seven years.

The defendants urge that the most appropriate way to make the adjustment is to decrease Cole's percentage interest in the Partnership, to reflect the lesser degree of risk that he assumed from and after 1991 until the merger. At trial the defendants established that as of October 1993, Cole had made only 59% of his required contributions. Accordingly, the defendants propose that Cole's 12.5% interest in the Partnership be adjusted downwards by 59%, thereby reducing his interest to 7.38%.

I cannot accept either approach in its entirety. Cole's proposal is flawed insofar as he fails to add interest to the principal amount of the unpaid cash calls. Interest is necessary in order to capture the time value of the money Cole failed to contribute.[61] Nor does Cole's approach account for the more speculative nature of the venture in October 1993, at which point the risk to the partners was far greater than it is today. Allowing Cole to pay his cash calls years after the fact, now that hindsight has established that the Project has succeeded, and without paying any interest, would unduly benefit Cole at his partners' expense.

The defendants' proposal is even more problematic. While the defendants' approach may account theoretically for the difference in relative risk, I am

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[61]Recognizing that the Court might so hold, the plaintiff states that if an interest rate applies, the "rate [should be] equal to not more than 1% over the prime rate prevailing at WTC." Pl. Post-trial Rep. Br. at 27, fn. 16.

extremely reluctant to diminish Cole's Partnership interest percentage as a remedial matter, where neither the Partnership Agreement nor any Delaware statutory or case law cited to me validates that approach. For this Court to rewrite the Partnership Agreement to alter a partner's ownership interest without any legal basis, would clearly overreach.

I conclude that the most appropriate way to adjust for the risk and expense Cole should have (but did not) assume between 1991 and October 1993 is to require him to pay the principal amount he owes -- approximately $62,370 -- plus interest at a rate that would reflect the rate of return an investor willing to buy into Cole's highly speculative position in the Partnership in 1991 would likely have demanded. That approach has the virtue of requiring Cole to account for both his fair share of the Partnership expenses, and for the risks he shirked. The parties' supplemental submissions should include argument as to what interest rate is most appropriate to accomplish this purpose.

3. Attorneys' Fees

Finally, the plaintiff argues that he is entitled to recover costs and attorneys' fees. He claims entitlement on the basis that the defendants acted in bad faith by effecting a merger that they knew would terminate Cole's interest in the venture, yet provide no notice to Cole.

This claim lacks merit. Although I agree that the defendants would have been well advised to seek a pre-merger judicial declaration of the rights of the parties a-nd of the value of Cole's interest, and although the defendants were in any event obligated to give Cole advance notice of the merger, their failure to take these steps does not establish that they acted in bad faith. Indeed, I have found that the defendants, reasonably and in good faith, proceeded with the merger as the only way to ensure that the venture would be able to continue. To be sure, the manner that the defendants chose to effectuate the merger violated their fiduciary duty, but that conduct did not rise to the level of egregiousness required to justify fee shifting. The defendants' request for attorneys' fees is therefore denied.

IV. CONCLUSION

Counsel for the parties shall confer and submit a form of order that implements the rulings made herein.