IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

IN RE PRIME HOSPITALITY, INC. SHAREHOLDERS LITIGATION	))	CONSOLIDATED Civil Action No. 652-N

MEMORANDUM OPINION

Submitted: February 1, 2005
Decided: May 4, 2005

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CHANDLER, Chancellor

This case involves the adequacy and fairness of a proposed settlement to this consolidated class action. The claims giving rise to the lawsuit arise out of the sale of Prime Hospitality Corporation to the Blackstone Group. Two separate lawsuits were originally filed, challenging the sale on a variety of grounds. A settlement was quickly struck, and the consolidated cases were provisionally certified as a class action for purposes of the settlement under Rule 23(e). At the hearing on the merits of the proposed settlement, a member of the class, Sheet Metal National Worker's Pension Fund ("Sheet Metal" or "Objector") objected.

Sheet Metal raises two objections. The first is premised on the procedural requisite that a representative plaintiffs' counsel must at all times adequately and vigorously protect the entire class' interests. Sheet Metal contends that this duty includes accounting for any developments since the signing of the settlement agreement. Pointing to events that occurred after the challenged transaction closed, Sheet Metal insists that Prime's board of directors failed to adequately inform itself of the value of Prime. Upon discovering this, plaintiffs' counsel (Sheet Metal argues) should have revoked its offer to settle, abandoned its perfunctory discovery and dug deeper into the circumstances of the sale.

Sheet Metal's second objection is based on the principle that a settlement agreement that asks the class to sacrifice a facially credible claim for small consideration is unfair and should be rejected. Sheet Metal maintains that if Prime's directors were indeed uninformed, defendants' supplemental disclosures would not be adequate or fair consideration for the release of litigable *Revlon/Macmillan* claims.

Approximately five months have passed since the filing of the amended consolidated complaint. This limited time frame has produced a paltry record with numerous untested allegations and theories—on both sides. Deciding on the fairness of a settlement (and the strength of the underlying claims) based upon such imperfect knowledge and a record so incomplete is never ideal. For the reasons set forth below, I cannot conclude that the proposed settlement, as structured presently, is fair and adequate. Accordingly, in the exercise of my discretion, I decline to enter an order and final judgment in this matter.

I. BACKGROUND

A. Prime Hospitality

Prime Hospitality Corporation was a publicly traded Delaware corporation that owned, managed, and franchised limited service and full service hotels. Prime operates its hotels throughout North America under

three proprietary hotel brands—AmeriSuites, Wellesley Inns & Suites and Prime Hotels & Resorts. Prime's board of directors is comprised of seven members. Of those seven, only two are insiders: A.F. Petrocelli, who serves as Prime's Chairman, President and CEO, and Richard Szymanski, who serves as Senior Vice President and CFO.

In the early 2000s, Prime's financial performance mirrored the overall downturn endemic to a hotel industry plagued by soft market conditions and the economic effects of the September 11th calamity. In fact, despite boasting a 13.7 percent increase in revenue and a 13.8 percent growth in EBITDA in 2000, Prime experienced a decline in revenue of 13 percent and 15.3 percent in years 2001 and 2002, respectively, and a decrease in EBITDA of 33 percent and 32.9 percent for those same periods.[1]

By 2003, however, Prime's financial decline was slowing. In the midst of an economic upturn, Prime recommitted to its long-term strategy of growth and improvement and revamped its brand infrastructure through the development of "a new central reservation center, an upgraded frequent guest program and increase[d] market spending."[2] The extent to which these initiatives affected Prime's financial health remains unclear; still, by June

[1] Consolidated Amended Class Action Complaint ("Compl.") ¶ 20.
[2] Defs.' Mem. of Law in Opp'n to Obj. of Settlement ("Defs.' Mem.") Ex. B ("Prime Hospitality Corp. 10-K") at 1.

30, 2004, the company was again showing increasing revenues.[3] In fact, Petrocelli boasted that these initiatives sparked the company's "second quarter results . . . [of] an 8.1% increase in average daily rate[s]."[4] Thus, whether it was the market upturn in general, or Prime's specific business plan, the company's financial outlook—by the second quarter of 2004—portrayed a picture of an underperforming asset with the prospect for favorable income growth in the future.

B. Blackstone's Interest In Prime

Blackstone is a private equity firm involved in a wide range of investment and advisory businesses. Blackstone's success is in part predicated on a business model that uses financial leverage to buy out a company; it then later sells the assets off in pieces at a higher value.[5] Of particular relevance here is Blackstone's United States real estate investment group—a division of Blackstone responsible for identifying investment opportunities and acquiring assets located in the United States. Approximately one-third of Blackstone's United States real estate group is focused on the lodging industry. As early as 2001, Blackstone began developing its extended stay hotel holdings. These holdings primarily

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[3] Compl. ¶ 21.
[4] *Id.*
[5] *See* Letter from Joseph A. Rosenthal to Chancellor Chandler regarding the proposed settlement ("Pls.' Let.") (Jan. 28, 2005) at 7.

consist of efficiency units that provide its guests with amenities suitable for periods beyond the needs of the casual vacationer (*i.e.* the units have built in stove tops and kitchens).

Blackstone's extended stay portfolio was in part developed through the acquisition of four assets. The first was the 2001 acquisition of Homestead Villages. In May 2003, the second acquisition was completed through the purchase of approximately 17 units under the Main Stays brand. In May 2004, Blackstone closed its third acquisition through its purchase of the Extended Stay America ("ESA") brand. The fourth was the October 2004 retention of 37 Wellesley Inns units (as well as other assets and liabilities) formerly owned by Prime.

Long before the October 2004 buyout of Prime, Blackstone began to show an interest in the company and specifically the 37 Wellesley units. Blackstone believed that these 37 units were suitable to develop its extended stay portfolio, but Prime's other assets were of little interest. This acquisition model led to two attempted strategic partnerships, in the summer of 2003, where Blackstone, in conjunction with another leader in the hotel industry, would reach out to Prime. The first contact was the Blackstone-Hilton interest. This partnership was initiated by David Gray, the managing director of the United States real estate group, who on the advice of an

unidentified source,[6] reached out to Matt Hart, the CFO of Hilton, to discuss Prime as a target. Then, both Gray and Hart together contacted Petrocelli to express their interests in acquiring Prime. In response, Petrocelli caused Prime to enter into a confidentiality agreement and directed Szymanski to coordinate due diligence. The Blackstone-Hilton interest evaporated quickly after preliminary due diligence. Gray attributed this failure to Hilton, who had refused to move forward on the transaction.[7]

The second of the 2003 Blackstone partnerships was formed with Hyatt. Unfortunately, the current record fails to disclose the nature of the discussions between Blackstone, Hyatt, and Prime. For example, the record is unclear as to whether this strategic partnership was formed before or after the Hilton one. Also, it remains unknown why these discussions never produced an offer. Finally, it remains inexplicable why the one Prime insider, who was charged with coordinating due diligence on behalf of Prime, was neither asked about, nor mentioned anything about, this contact. Thus, the only definitive fact that the Court can accept is that, by the end of 2003, Blackstone was unsuccessful in realizing the strategic opportunities it believed Prime possessed.

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[6] During Gray's deposition he was unable to recall whether the source was an investment bank or an internal one. *See* Deposition Transcript of David Gary ("Gray Dep.") at 15:20-22.

[7] *Id*. at 14:2-5.

C. La Quinta Expresses Interest in Prime

Six months after the Blackstone-Hilton talks failed, La Quinta Hotels expressed an interest in Prime and sought permission to conduct due diligence. According to Szymanski, La Quinta's request was communicated to the board and the board authorized Szymanski to cooperate.[8] The record indicates that this was the first time Prime's board was actively involved in considering a solicitation at the time the solicitation was made and signaled the first time that Prime considered, on a board level, that it would abandon the corporation's continued existence.[9] Before this, the record is meager at best as to when the board knew a solicitation was made and what the board knew while the negotiations were occurring.

Prime's talks with La Quinta never progressed beyond the initial stages. But there is discrepancy as to why. The Proxy Statement suggests that La Quinta had offered a price below the eventual Blackstone offer and that Prime's board rejected it.[10] Szymanski's deposition, however, indicates that the deal failed because, after La Quinta received the information it needed, it decided not to proceed.[11] Noticeably absent from Szymanski's testimony was any narration of an act of Prime's board in response to any

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[8] Deposition Transcript of Richard Szymanski ("Szymanski Dep.") at 31:14-21 & 32:12-21.

[9] *See id*. at 31:14-21.

[10] Prime Hospitality Corp.'s Schedule 14A ("Proxy Statement") (Sept. 10, 2004) at 14.

[11] Szymanski Dep. at 34:7-9.

offer. Attempting to fill this gap, Szymanski supplemented his deposition testimony by submitting an affidavit. The affidavit suggests that Szymanski's deposition testimony was not inconsistent, and what was meant was that after Prime had rejected La Quinta's offer, La Quinta declined to negotiate further.[12]

D. Blackstone Re-emerges

Blackstone's 2004 acquisition of ESA marked the third acquisition in its developing extended stay portfolio. That transaction was submitted in March and Bear Stearns was retained by Blackstone to facilitate the acquisition.[13] This is not the first time Bear Stearns assisted Blackstone in acquiring extended stay properties. The first time was in 2001, with the acquisition of Homestead Villages.[14] The ESA transaction closed in May 2004.

On the heels of the ESA deal—in fact, the same month that Blackstone was closing the ESA deal—Prime requested that Bear Stearns begin to explore the market for its 37 Wellesley Suites.[15] That request ended up in the lap of Blackstone and, shortly after the customary confidentiality

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[12] *See* Affidavit of Richard Szymanski ("Szymanski Aff.") ¶ 6. For reasons more fully discussed in the analysis section of this Opinion, I am unpersuaded that this submission has the sterilizing effect that defendants had hoped it would.
[13] Deposition Transcript of Charles S. Edelman ("Edelman Dep.") at 31:4-5.
[14] *Id.*
[15] Szymanski Dep. at 73:21-25 & 72:3-5.

agreement was signed, Blackstone, for a third time, had access to Prime's financial information. Blackstone explored this possibility for approximately a month, and then submitted its bid. Prime, apparently making short shrift of the bid, rejected Blackstone's offer[16] and the prospect of Prime selling off 37 of its Wellesley Suites to Blackstone ended in June 2004.

The decision to use Bear Stearns, as an intermediary and financial advisor, most likely stemmed from Petrocelli's familiarity with Bear Stearns, which dates back to at least 2000.[17] Nevertheless, the exact nature of Prime's engagement with Bear Stearns remains unclear. Charles Edelman, a Bear Stearns representative, explained that Bear Stearns had been in contact with Prime's management for many years and that "they asked us to consider whether anyone would be interested in buying a portfolio of their Wellesley properties."[18] Edelman further explained that Bear Stearns worked with Prime specifically during (1) the discussions with Blackstone and Hilton in 2003, (2) the discussions with Blackstone and Hyatt in 2003 (although Szymanski does not even mention this in his deposition), (3) the La Quinta offer in 2004, (4) the failed Wellesley sale to Blackstone in 2004,

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[16] Szymanski was never asked why the bid failed, but Gray testified that the bid was rejected in short order. *See* Gray Dep. at 21:20.

[17] Edelman Dep. at 22-23.

[18] Edelman Dep. at 33:21-25 & 34:2-4.

and (5) the successful acquisition of Prime in 2004.[19] Edelman makes no mention, however, whether Bear Stearns disclosed to anyone at Prime that Bear Stearns was retained and actively facilitating deals for Blackstone in the exact industry as the Wellesley Suites. In fact, when plaintiffs' counsel began to explore Bear Sterns' interaction with Prime, and whether Bear Stearns "routinely provid[ed] advice to entities on both sides of a potential transaction,"[20] the question was met with an objection, an *off the record discussion*, and an immediate redirection into a more benign line of questioning.[21]

E. Blackstone Acquires Prime

Blackstone sat on Prime's rejection of the Wellesley offer for approximately a month. Then, in June 2004, Gray believed there was the potential for a "larger opportunity"[22] and that a look at the entire company was warranted. Blackstone reached out to Bear Stearns, advising that "unlike the previous year, where we were not prepared to buy AmeriSuites, we're now—we think that what makes the most sense is for us to look at the

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[19] *Id*. at 31-34.
[20] *Id*. at 29:12-25.
[21] Edelman's deposition testimony never revealed whether this potential conflict was disclosed. Edelman, however, was not the Bear Stearns representative present at Prime's board meetings; it was Lonny Henry. The Court had to discover for itself that *the only disclosure of the conflict occurred on August 18 when Bear Stearns submitted its engagement letter*. This letter was filed with the Proxy Statement.
[22] Gray Dep. at 22:17.

whole business."[23] Gray was then unclear about what happened next, but he suggested that there might have been a discussion on price.[24] Blackstone and Prime signed yet another confidentiality agreement and Prime opened its books.

In July 2004, Blackstone completed its financial analysis. On July 26, Blackstone contacted Petrocelli by phone and offered $12.00 a share. Petrocelli responded to the price, over the phone, and stated that the price was inadequate, that he would take the offer to the board, but that his recommendation would be to decline the offer.[25] Later that same day, Petrocelli and Bear Stearns were able to persuade Blackstone to raise its price 25-cents, to $12.25 per share[26] for a proposed maximum aggregate transaction value of $570 Million.

Despite Petrocelli's representation to Blackstone that he would bring the offer to the board, the record indicates that the first time Petrocelli communicated to the board was at a regularly scheduled board meeting held on July 27, 2004—a day *after* the negotiations had occurred and *after* the final price had been agreed upon. The board's minutes indicate that the majority of this meeting was dedicated to Szymanski's presentation on

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[23] *Id*. at 24:3-17
[24] *Id*.
[25] *Id*. at 29:16-23. The Court must rely on Gray's deposition and the Proxy Statement for these facts; *Petrocelli was never questioned.*
[26] Proxy Statement at 14.

Prime's financial outlook—and *not the possibility of selling the company*.[27] In fact, the first mention of the Blackstone offer does not occur until the end of the meeting. Then, in the single paragraph devoted to the issue, the board minutes reflect that Petrocelli "advised the board that he had received an inquiry from a potential acquirer as to whether the Corporation would consider an offer."[28] With no other description of what transpired between Petrocelli, Blackstone and Bear Stearns the day before, the board authorized Petrocelli to ascertain from the "acquirer the terms that it proposed" and to report back.[29]

During the period from July 27 to August 5 Blackstone allegedly continued its due diligence. On August 5, a draft merger agreement was circulated. On August 12, Prime's board met for a second time to consider the offer. The minutes of this telephonic meeting outline a very detailed presentation given to the board and begin with Petrocelli describing the tentative timeline for closing the deal. Then, Prime's legal counsel discussed the key merger terms—the consideration paid; the need for a Proxy Statement; Petrocelli's voting agreement and the voting agreement of

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[27] *See* Letter from Joel Friedlander to Chancellor Chandler regarding the proposed settlement ("Obj.'s Let.") (Jan. 18, 2005) Ex. B ("July 27 Board Minutes").
[28] *Id.*
[29] *Id.*

United Capital Corporation (a company Petrocelli controlled); the date of closing; the amount of the break up fee; and other matters.[30]

After the legal presentation, Bear Stearns provided a background to the merger and outlined several discussions the Company had with strategic buyers. Among the contacts already described above, there was an additional one—Inter Continental Hotel and Resorts. Bear Stearns then informed the board that the price offered by Blackstone was a 40 percent premium over the current stock price. The August 12 meeting concluded with Petrocelli reminding the board that they needed to consider whether to retain Bear Stearns as the company's financial advisers for the proposed merger. After a brief discussion, a resolution was passed authorizing Prime to engage Bear Stearns to provide a fairness opinion[31] and to adopt the provisions of an engagement letter entered into on August 10.[32] The engagement letter purports to authorize Bear Stearns to search for strategic alternatives.[33] According to Szymanski, Bear Stearns was hired because "Bear Stearns had done work for the company in the past,"[34] and despite

[30] *Id*. Ex. C. ("Aug. 12 Board Minutes").
[31] *Id*.
[32] *See* Sheet Metal Workers' Nat'l Pension Fund's Obj. to Proposed Settlement, Ex. 3 ("Bear Stearns' Engagement Letter") at 1.
[33] The extent Bear Stearns canvassed the market is unknown as all instructions to Bear Stearns was handled through Petrocelli who was never questioned about the transaction. *See* Szymanski Dep. at 74:6-24.
[34] Szymanski Dep. 65:18-21.

using other banks in the past, Prime's board did not consider any other firm.[35] The record fails to disclose whether the board knew at this time that Blackstone also had retained Bear Stearns in the past for their Homestead and ESA deals.

The final meeting of Prime's board was on August 18, just six days after Prime's board authorized Bear Stearns to canvass the market. At this meeting, Bear Stearns delivered its financial presentation to the board. Following questions by the board, the board voted to approve the merger agreement (with the exception of Petrocelli who abstained) and declared it advisable to its shareholders. The merger agreement provided that in the event the deal was terminated Prime would pay a $23 million termination fee (4.7% of the implied equity value of the deal), and $4 million in expenses. Prime was also prohibited from actively soliciting third-party bids, and could entertain unsolicited third-party bids but only after concluding in good faith it could result in a superior offer. These provisions presumably superseded Bear Stearns' authorization to "explore strategic alternatives."[36] Prime publicly announced the deal the same day, August 18, 2004.

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[35] *Id*. at 65:13-15, 22-25.
[36] Bear Stearns' Engagement Letter at 1.

On September 10, 2004, Prime filed its Proxy Statement and mailed it to its shareholders. On September 20, this consolidated and amended class action complaint was filed. The complaint alleges that the merger consideration received by Prime's shareholders was inadequate, the acquisition was not the result of a full and fair sales process, and that the Proxy Statement failed to disclose certain material information. Three days later, on September 23, 2004, the plaintiffs' counsel reached an agreement in principle to settle the consolidated action on the basis that Prime would make certain supplemental disclosures. These additional disclosures were filed and mailed on September 24, 2004. On October 6, the merger agreement was ratified by 99.9 percent of the shareholders who voted on the issue. No competing bid emerged between the public announcement on August 18 and the shareholder vote on October 6.

Three months after Blackstone closed the deal with Prime, plaintiff's counsel received a letter from Sheet Metal requesting copies of the discovery for immediate review so that the terms of the settlement could be evaluated in light of "recent news reports."[37] Apparently, the "news reports" Sheet Metal was referring to was an article in *The Deal.Com* that disclosed Blackstone's sale of AmeriSuites to Hyatt for $645 Million—a price greater

[37] *See* Defs.' Mem. Ex. D.

than Blackstone had just paid for *all* of Prime's assets. On December 30, Sheet Metal filed its objection to the proposed settlement.

F. The Objector's Contentions

Sheet Metal objects to the proposed settlement on two grounds. The first objection challenges whether plaintiffs' counsel adequately and vigorously represented the interests of the absent class. Fueling this objection is that plaintiffs' counsel has failed to produce a record that answered pivotal questions or rebutted Sheet Metal's assertions. Instead, the Objector contends that "plaintiffs capitulated on their *Revlon* claim" and relied on a record of "unsupported assertions, innuendo, . . . the admittedly inaccurate Proxy Statement, . . . [and] an un-cross-examined affidavit."[38] Relying upon *Prezant v. De Angelis*,[39] the Objector argues that the proponents of a settlement cannot rely on an inadequate record created by defendants. In concluding that plaintiffs counsels' representation was inadequate, the Objector insists that an adequate and vigorous advocate would, at a minimum, have gone back to the table and demanded more information when confronted with the news that Blackstone flipped Prime's crown jewel for more than Blackstone paid for all of Prime's assets.

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[38] Letter from Joel Friedlander to Chancellor Chandler regarding the proposed settlement (Feb. 1, 2005) at 2.
[39] 636 A.2d 915, 923, 925 (Del. 1994).

The Objector's second objection alleges that Prime's directors were not diligent in "informing themselves of all information reasonably available and deciding which alternative is most likely to offer the best value reasonably available to the Stockholders."[40] Objector predicates this alleged breach of duty on its notion that despite the lack of any special circumstance that may permit a passive market check, "Prime's board failed to canvass the market (or discuss doing so) and . . . reached a quick agreement."[41] Then, with "no reasonable basis upon which to judge the adequacy of the contemplated transaction,"[42] the dominated and supine board approved a merger agreement that was: (1) recommended by a conflicted financial advisor; (2) provided Petrocelli—the 60 year old CEO—with an immediate liquidity event; and (3) contained undue restrictions on third-party bids.[43]

G. Defenses to the Objector's claims.

The plaintiffs' counsel (and, of course, the defendants) now join hands and contend that the *Revlon* claim is absolutely worthless and should be released. They also insist that the supplemental disclosures were more than adequate and fair consideration for the released claims in light of the significant defenses available.

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[40] Obj.'s Let. at 5.
[41] *Id*.
[42] *Id*. at 8.
[43] *See id*.

Moving to the Objector's challenge regarding Prime's board, the settlement Proponents point out that any claim for monetary damages would prompt defendants to "invoke the shield against damages liability under 8 *Del. C.* § 102(b)(7)."[44] Next, they note that the challenged transaction was ratified by a majority of fully informed and disinterested shareholders. Finally, they maintain that any challenge to the Prime/Blackstone transaction would be futile as: (1) the deal was approved by a majority of disinterested directors; (2) the deal with Blackstone was not decided in a vacuum but was part of a "body of reliable evidence;" (3) Petrocelli's interests were exactly aligned with the shareholders; (4) Bear Stearns' fee was reasonable and structured to procure the highest bid; and (5) the termination fee and other deal protection devices were reasonable and did not preclude a post-signing market check.

II. ANALYSIS

A. The Standard Applied to Settlement Proposals

When approving a class-action settlement, the Court will protect the interests of the absent class members by "balanc[ing] the policy preference for settlement against the need to insure that the interests of the class have

[44] Pls.' Let. at 8.

been fairly represented."[45] Without trying the issues presented, the Court carefully considers all challenges to the fairness of the settlement.[46] Then, with its own yardstick—*i.e.*, the Court's own business judgment—the Court measures the consideration plaintiffs will receive for the release of their claims, against the "nature of the claims, the possible defenses thereto, and the legal and factual circumstances of the case."[47] If, in light of these factors, the Court determines that the plaintiff class received fair consideration, then approving the settlement and dismissing the case with prejudice would be justified.[48] On the other hand, "if the [Court] were to find that the plaintiff class was being asked to sacrifice a facially credible claim for a small consideration . . . rejecting a settlement as unfair would be appropriate."[49]

With this standard in mind, the question now before the Court is whether I, acting as a fiduciary for the class, can in good conscience allow the release of all claims against Prime's individual directors, Blackstone, Blackstone's affiliates, and any other affiliate of any defendant, which in this

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[45] *Barkan v. Amsted Indus., Inc.*, 567 A.2d 1279, 1283 (Del. 1996) (citing *Rome v. Archer*, 197 A.2d 49, 53 (Del. 1964)).
[46] *Barkan* at 1283-1284.
[47] *See id*. (relying on *Polk v. Good*, 507 A.2d 531, 535 (Del. 1986) and *Rome*, 197 A.2d at 53).
[48] *Id*. at 1285.
[49] *Id*.

case would include Bear Stearns.[50] This decision is not an especially easy one. Defendants have created a facially sterile record. What is troubling, however, is the doubt that remains with me when I ask whether that record could withstand the weight of a piercing investigation? Had I been able to answer this question in the affirmative, the conclusion reached here today may well have been different. Indeed, our law must remain predictive and certain, if it is to have any utility to managers and directors in guiding good fiduciary behavior. But, the application of Delaware law should never be so formalistic that superficial compliance with fiduciary standards will be a substitute for the kind of behavior that underlies our business judgment rule's presumptions. Ultimately, the record may fail to bear out inequitable conduct taken at the expense of the class. But despite this hurdle, I conclude that enough doubt has been raised about the fairness of this settlement that I cannot in good conscience approve it.

B. Weighing the Claims vs. the Defenses

1. Prime's 102(b)(7) Defense

The analysis of attributing value to the release of the claims must begin with the reality that the challenged transaction has closed and neither

[50] Bear Stearns has not been named in this suit but is included in the Settlement Proposal.

injunctive relief nor rescission is available.[51] When claims for monetary damages are predicated upon alleged breaches of fiduciary duty, the Court cannot ignore the effect that a corporation's exculpatory provision will have on the analysis. Thus, if a more complete record would bring forth facts that suggest that Prime's directors breached their fiduciary duty to "secure the highest value reasonably attainable for the stockholders,"[52] the claims are of little or no value unless that failure is predicated upon the directors' disloyalty or bad faith.[53]

2. <u>Shareholder Ratification</u>

The effect of shareholder ratification on the value of these claims is more complex. If the claims amount to a breach of the duty of care, and no more, shareholder ratification is significant, as it would provide the defendants with an additional layer of protection, precluding recovery.[54] On the other hand, if the board's conduct was predicated upon its disloyalty or

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[51] *See McMillan v. Intercargo Corp.*, 768 A.2d 492, 500 (relying on *Gimbel v. Signal Cos., Inc.*, 316 A.2d 599, 603 (Del. Ch. 1974), *aff'd*, 316 A.2d 619 (Del. 1974) for the proposition that a completed merger cannot, as a practical matter, be unwound). *See also Unitrin, Inc. v. American General Corp.*, 651 A.2d 1361, 1374 (Del. 1995) (discussing the difference between the standard that a court uses to determine whether to enjoin a transaction and the one it uses to determine whether to hold directors liable for damages).

[52] *McMillan,* 768 A.2d at 502.

[53] *See In re Lukens*, 757 A.2d 720, 732-733 (Del. Ch. 1999) (dismissing *Revlon* claims because complaint did not adequately allege facts that directors acted in bad faith or disloyally).

[54] *See In re Wheelabrator Tech. Inc., S'holders Litig.*, 663 A.2d 1194, 1200 (Del. Ch. 1995) (dismissing on summary judgment plaintiffs' due care claim when merger was approved by fully-informed disinterested shareholder vote).

bad faith, shareholder ratification may only reduce the value of the claims—without extinguishing them—or, depending on the facts alleged, may have no effect, thus significantly reducing defendants bargaining strength. Indeed, it is possible, on the one hand, that the facts adduced on a more complete record would lead the Court to conclude that shareholder ratification had trumped allegations of self-interest or bad faith and that the presumptions of the business judgment rule should guide the Court's decision.[55] It is equally possible, however, that the facts would point in a different direction: that shareholder ratification should have no effect, forcing defendants to defend their claim in the context of entire fairness.[56]

Identifying the potential effects that both an exculpatory provision and shareholder ratification might have on the value of this settlement is only part of the Court's task. Now, that law must be applied to the facts. This is what makes this case so troublesome, as the record is not sufficiently developed to engage in a meaningful application of the law to the facts. I am, quite frankly, not at all confident that plaintiffs' counsel have exhausted all relevant lines of inquiry regarding the strength of their claims. The defendants portray their defenses as ironclad—and they may be. But I

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[55] *Id. See also Solomon v. Armstrong*, 747 A.2d 1098, 1117 (Del. Ch. 1999).

[56] *See In re Santa Fe Pacific Corp. S'holders Litig.*, 669 A.2d. 59 (Del. 1995) (finding incongruity between the proposal voted on and the subject matter of the claimed breaches of fiduciary duty).

cannot reach that judgment on the paltry record that appears to have been carefully constructed in this case.

C. The Strength of the Record

The discomfort I have with releasing all claims in exchange for the September 2004 supplemental disclosures stems from the difference between the sterilized version of events proffered by the settlement's Proponents and the significant questions raised by the existing record. The Proponents, for example, argue that, over the course of the past four years, it was well known in the industry that Prime was for sale at the right price and had "freely communicated with interested parties."[57] The market for Prime produced at least six potential suitors: Marriot, Starwood Hotels, Hyatt, Hilton, La Quinta and Blackstone. Only Blackstone emerged with the best deal reasonably available. The Proponents, therefore, contend that active and disinterested directors, who possessed a body of reliable evidence as to Prime's value, and who were aided by an independent financial advisor, approved the Blackstone transaction and its concomitant protective measures.

Standing in contrast to the Proponents version of events leading up to Blackstone's acquisition of Prime is the record created by the confirmatory

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[57] Letter from Raymond J DiCamillo to Chancellor Chandler regarding the proposed settlement (Jan. 28, 2005) ("Defs.' Let.") at 4.

discovery. In the current record, I find four major areas of concern, all of which plaintiffs' counsel have failed to adequately address. The first two areas involve the market information in the board's possession both before and after the deal with Blackstone was signed. The record in this regard was based heavily on the deposition testimony of Richard Szymanski. Szymanski was named to Prime's board sometime between late 2003 and 2004 (he could not recall),[58] and attended board meetings regularly since 1997. He was the only board member who was questioned by plaintiffs' counsel and who possessed the ability to attest to what the board knew and when they knew it. To say that his testimony was underwhelming would be an understatement, to put it mildly. The next concern, namely the ability of the Court to assess the reasonableness of the deal protection devices, arises because I cannot determine whether or not the board possessed a body of reliable evidence. The final concern arises because Petrocelli, the Chairman and CEO of Prime, was never questioned. He was the one Prime insider who possessed the most information concerning the Blackstone transaction. Petrocelli was a highly material witness whose testimony regarding Blackstone and Bear Stearns would appear critical to plaintiffs' case. Yet,

[58] Szymanski Dep. at 17:9-10.

this important source of information about events leading up to the sale of Prime is absent from the record. I address these concerns in turn.

1. Prime's Market Check From July 2003 to February 2004

According to the Proxy Statement, the Blackstone-Hilton overture was one of four contacts with Prime that, beginning in 2003, would serve as the board's body of reliable evidence. Szymanski's knowledge of that transaction, however, seems tied to what Petrocelli told him. In fact, after Petrocelli was contacted by Blackstone and Hilton, Szymanski was directed to coordinate due diligence. Szymanski had no contact with Blackstone, but rather understood the offer to be from Hilton alone.[59] According to Szymanski, Blackstone was not a direct acquiror but had interest in purchasing 37 of the Wellesley assets from Hilton should that deal close.[60]

Further discrediting the assertion that Prime's board was kept abreast of active solicitations is that the record contains no instance where the board authorized anyone at Prime to facilitate the talks between Blackstone, Hilton and Prime. It is clear, however, that Bear Stearns was involved. Was this at the behest of Petrocelli? And if it was, why is there no document in the record that would provide a contemporaneous link between Petrocelli's

[59] *Id.* at 22:10-11 & 26:16-24. These statements, however, are at odds with the Proxy Statement, as the Proxy suggests that both Blackstone and Hilton worked cooperatively with the company during the July 2003 talks.
[60] Szymanski Dep. at 71:8-14, 21-25, & 72:2-3.

attempt to sell off Prime and a directive from the board to do so? The Court's only window into the process followed by Prime's board is via Szymanski. He, however, had no recollection of how Bear Stearns' authorization came about,[61] and was very unclear as to the nature of the Blackstone-Hilton Interest. Comparing this to what was disclosed in the Proxy Statement, Szymanski's testimony calls into question the notion that Petrocelli communicated openly with Prime's board and undermines the assertion that Prime's board possessed a body of reliable evidence.

The Blackstone-Hyatt talks are equally troubling. Although not disclosed in the Proxy Statement, these talks helped form a second link in the alleged body of reliable evidence upon which the Proponents so heavily rely. Similar to the Hilton talks, however, the record raises as many questions as it purports to answer. When deposed, Charles Edelman of Bear Stearns indicated that during the summer of 2003 Hyatt emerged and both Hyatt and Blackstone—as strategic partners—expressed an interest in Prime. The talks progressed and during the due diligence stage, Bear Stearns, acting

[61] *Id*. at 38:17-24.

as the company's "financial advisor,"[62] allegedly provided advice to Prime's senior management regarding the state of the lodging industry.[63]

Edelman's deposition was the first time the Blackstone-Hyatt contact appeared in the record. It was not in the Proxy Statement and Szymanski did not mention it.[64] Why would the Prime board member who could testify to the depth of the body of reliable evidence in the board's possession, not only not be questioned concerning this contact, but also completely omit the contact from his testimony? This market contact would seem to be an important piece of the puzzle in light of an allegation that Prime's directors failed to achieve the highest value reasonably available. Moreover, it would seem to assume even greater prominence as a result of Blackstone's sale of AmeriSuites to Hyatt. Inexplicably, plaintiffs' counsel simply accepted Bear Stearns' assertions concerning this contact, despite Szymanski making no mention of Hyatt in his deposition six days before Edelman's deposition.

Turning to La Quinta's offer, this is the first time that the record shows an actual decision by Prime's board to consider an unsolicited third-party bid. What is left unclear is why, and why now? The La Quinta deal

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[62] According to the Proxy Statement, Bear Stearns was the company's financial advisor. *See* Proxy Statement at 14.
[63] Edelman Dep. at 25-26.
[64] *See e.g.*, Szymanski's Dep. at 71:9-25 & 72:2-25 (indicating that through the period of 2003 and 2004 Prime was contacted by Blackstone-Hilton, La Quinta, and Blackstone alone).

represented the decision of Prime's board to abandon the corporation's continued existence. Yet, in light of Prime's March 2004 10-K, Prime's intent was to continue the seven-year strategy of moving into a diversified company and selectively acquiring hotels or hotel chains. Why was this long-term strategy discarded in the summer of 2003, and again in January 2004, then reaffirmed in March 2004, only to be abandoned again five months later in July? Szymanski was never asked these rather basic questions.

Prime's interaction with Blackstone, Hilton, Hyatt and La Quinta raises multiple questions. The answers to these questions may be simple, but they are answers missing from the record. Their absence does little to reassure the Court that Prime's board was actively engaged in an "unbroken and continuous line of very serious solicitations and/or negotiations for the purchase of [Prime]."[65] Before May 2004, the record discloses only one instance of Prime's board making a deliberate choice to consider a strategic alternative to its continued existence—albeit from a source that at this point would face serious challenges to credibility.[66] Thus, before the La Quinta offer, the record is full of gaps between the Proponents' sanitized version of

[65] Pls.' Let. at 2.

[66] I mentioned earlier that I do not rely heavily on the submission of the Szymanski affidavit and I reaffirm that observation here. The affidavit is a self-serving document produced after discovery and not subject to cross-examination.

events leading up to the July 2004 Blackstone offer and the deposition testimony elicited by plaintiffs' counsel.

2. Prime's Market Check After February 2004

The questions only continue to mount with Blackstone's acquisition of Prime. The Proxy Statement discloses to the shareholders that Bear Stearns, beginning in early May 2004, was authorized by Prime to contact a limited number of potential buyers for the entire Wellesley Suites unit of Prime. Thus, according to the Proxy Statement, Bear Stearns was retained by Prime at the very same time Bear Stearns was in the midst of, or concluding, its representation of Blackstone in the ESA acquisition.

This disclosure raises two concerns. First, the deposition testimony indicates that Prime's board authorized the sale of only the 37 Wellesley Suites that were amenable to extended stay use. The authorization was not for the entire Wellesley portfolio. Why would the Proxy Statement disclose that Prime's board authorized the sale of almost a third of its hotel holdings when the actual authorization was limited to a very specific 18 percent of Prime's hotels?[67] Second, nowhere in the record is it disclosed that Bear

[67] Prime operated 260 hotels, 82 of which were under the Wellesley Suites Brand. Of those 82, only 37 were suitable for extended stay. *See* Prime Hospitality Corp. 10-K Item 1 and 2.

Stearns informed Prime—in May 2004—of its simultaneous engagement with Blackstone during the ESA deal.

In early July 2004, Blackstone abandoned the idea of working with a strategic partner and made its offer for all, not just part, of Prime. According to the Proxy Statement, Blackstone contacted Bear Stearns to express this intent. In turn, Bear Stearns contacted Petrocelli, who then authorized Bear Stearns to continue. On July 12, Blackstone and Prime entered into a confidentiality agreement and Blackstone performed due diligence. On July 26 Blackstone offered a $12.00 per share price for all of Prime. Then, that same day, Petrocelli rejected the offer as inadequate and, with the assistance of Bear Stearns, negotiated the higher bid of $12.25 per share. No other negotiations concerning the price are reflected in the record and the $12.25 per share is the price at which the deal closed.

Despite a month of acquisition talks, the first contact with Prime's board that appears in the record occurred on July 27 at a regularly scheduled board meeting (not a special meeting)[68] held at United Capital Corporation's headquarters (not Prime's offices in Fairfield, New Jersey).[69] According to the Proxy Statement, Petrocelli summarized for the board the conversations between Blackstone, himself and other senior management, and Bear

[68] *But cf.* Proxy Statement at 14.
[69] *Id.*

Stearns. Petrocelli then communicated the general terms of the proposal and from there the board authorized Petrocelli to continue discussions "to ascertain whether the proposal might form the basis for a transaction to be considered further by the board."[70]

The actual board minutes, however, paint a different picture. Despite there being one month of an active bidding process for the sale of the company—which to date had resulted in a signed confidentiality agreement, three weeks of due diligence, and negotiations that produced a price—the minutes depict business as usual and, with two concluding sentences, indicate that Petrocelli informed the board that "an inquiry from a potential acquirer as to whether the corporation would consider an offer"[71] was made. If more was discussed at this meeting, plaintiffs' counsel did not discover it.

The next board meeting occurred on August 12. During the meeting, Bear Stearns presented to the board the nature of the interests expressed in acquiring Prime over the past four years. Thus, these minutes represent one of only two pieces of contemporaneous evidence in the record that suggests Prime's board was informed of the talks the company allegedly held with potential buyers over the past four years. Despite this, several concerns still exist. First, it is unclear whether the board now knew that the advisor, who

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[70] Proxy Statement at 14.
[71] July 27 Board Minutes at 2.

was conveying the market check information, had also represented Blackstone in acquiring half of its extended stay portfolio.[72] Second, it appears that it was never considered by the board whether the price their CEO set in July could be increased. Third, if Proponents are hanging their hat on the assertion that the directors' decision to approve this transaction was based on a body of reliable evidence—which in large part was developed in reliance upon the Bear Stearns presentation—why would that presentation occur *after* a merger agreement was drafted, and Petrocelli had concluded that the purpose of the next meeting would be to approve the merger?[73] Finally, how can the Court attribute weight to the notion that Bear Stearns was retained by Prime to shop the company? The extent of Bear Stearns' authority to shop the company is unclear, especially given its dual role in the transaction. Once the lock-ups were signed, Bear Stearns' authority, whatever it was, and brief as it was, ceased.

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[72] Bear Stearns was retained by Blackstone to facilitate Blackstone's acquisition of Homestead and ESA. *See* Edelman Dep. at 31:4-5.

[73] This is not to suggest that directors cannot be self-informed of the value of the their company independent of a financial advisor's analysis. In fact, one would hope that would be the case. Nevertheless, the Court has no idea what this board knew and because the Proponents heavily rely on the Bear Stearns board book for the proposition that Prime's board was fully apprised of the industry landscape, it is appropriate to call into question the weight accorded by Proponents to the use of Bear Stearns in this transaction.

3. Prime's Deal Protections

On August 18, Prime's board approved a transaction that provided for a $23 million termination fee, a $4 million expense reimbursement, and both a no-shop and a no-talk clause. If Proponents are correct, and Prime was extensively shopped beginning in 1998, held serious negotiations with major players in the industry, and only received one actual offer, then one might be reasonably skeptical that Prime actually needed such extensive deal protections.[74] From whom were they protecting the deal? Moreover, because questions do exist as to the body of evidence the board actually possessed, the question whether these devices may have forestalled competing bids is of potential value to the shareholder class.[75]

4. Petrocelli

Petrocelli was 60 years old and held a significant amount of his wealth in illiquid assets. Drawing exclusively from the Proxy Statement, it appears that an immediate sale of all of Prime provided Petrocelli with an accretion in wealth of over $57 million. Of that amount, nearly 40 percent was

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[74] A termination fee of 4.7 percent of the implied equity value of the deal also seems high in the circumstance of this case.

[75] *See Barkan*, 567 A.2d at 1288 ("Where a board has no reasonable basis upon which to judge the adequacy of a contemplated transaction, a no-shop restriction gives rise to the inference that the board seeks to forestall competing bids."); *In re Pennaco Energy, Inc. S'holders Litig.*, 787 A.2d 691, 707 (suggesting that the decision to lock-up a transaction with onerous deal protection measures in light of failure to canvass the market may be met with great skepticism and may tilt a board's action toward unreasonableness).

derived from his severance package, change of control agreement, and stock option liquidity.[76] Thus, the Objectors contend that a significant percentage of Petrocelli's compensation was derived from an immediate sale of Prime and would not have accrued had Prime's board sold off its AmeriSuites assets alone.[77]

At this juncture, the Court is unconvinced that a liquidity event, alone, would misalign Petrocelli's interests with the interests of the public shareholders. It is often the case that such cash out incentives encourage executives to facilitate value-maximizing transactions. Nevertheless, the current sparse record suggests that: (1) Petrocelli's interests may not have been aligned with the shareholders; (2) Petrocelli did not communicate openly with the board; (3) Petrocelli used a conflicted financial advisor to assist the board; and (4) Petrocelli's efforts may have unduly influenced Prime's board into securing a deal that was not in the best interests of all the shareholders. At a minimum, plaintiffs' counsel should have questioned

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[76] Petrocelli received approximately $57 million inclusive of severance ($1.3 million), COC ($6.5 million), his holdings in United Capital Corp., vested and unvested options and direct holdings in Prime. At the time the deal was approved, Petrocelli held 4,075,000 vested options. Of these vested options, 75 percent (or 3,075,000) were underwater. In addition to the vested options, Petrocelli held another 750,000 options that were unvested but would vest upon the sale. The sale of Prime, therefore, provided Petrocelli with an opportunity to cash in 3,825,000 options (or approximately $14,335,625) that held zero-value in the open market. Thus, the severance payments, COC and option liquidity combined to make up 40 percent of the total $57 million Petrocelli received.

[77] *See* Obj.'s Let. at 7.

Petrocelli. He was Prime's insider who negotiated the sale price and clearly was the individual from whom Prime's board received their information concerning the deal.

D. The Supplemental Disclosures are Inadequate Consideration

The Proponents have submitted a record that is so sparse and inconsistent that I am unable to conclude that their *Revlon* claim was worthless. When Prime's board decided to abandon its continued corporate existence, the board assumed the sole responsibility of maximizing shareholder value. In foregoing an active market check, Prime's directors needed to act upon a body of reliable evidence. For the reasons discussed above, Prime's contacts with the market stretching from January 2003 until July 2004 are questionable at best.[78] First, there is little if any contemporaneous information in the record to support the Proponents' assertion that an "unbroken and continuous line of very serious solicitations and/or negotiations for the purchase of [Prime]"[79] indeed occurred. Second, the information that is in the record is inconsistent and untested. Third, if a more fully developed record elucidates what the current record suggests, the Proxy Statement, even with the supplemental disclosures, does not

[78] I give little weight to the defendants' reliance on the pre-2003 contacts, as it is doubtful any contact in the hotel industry before September 11, 2001, would provide reliable indicia of value four years later.
[79] Pls.' Let. at 2.

adequately disclose what happened. Fourth, there are reasons to question whether Prime's board received unbiased advice, both from its potentially conflicted CEO, and its clearly conflicted financial advisor. Finally, it remains doubtful whether the flaws in the pre-signing process were cured in light of a post-signing market check.

In sum, the record is too incomplete and has failed to satisfy me that the chain of events leading up to sale of Prime were as pristine as the Proponents would have me believe. In light of this, I am unconvinced that defendants' defenses are as strong as they assert. Because it remains unanswered what may have been unearthed had plaintiffs' counsel pressed more vigorously during the discovery, I am compelled to conclude that if I approve the supplemental disclosures as adequate consideration for the release of all claims and then award $325,000 in attorneys fees, I would be asking the absent class to sacrifice too much, for too little consideration. I therefore cannot approve this settlement.

III. CONCLUSION

It is the long-standing policy of this Court to favor settlement over litigation—nothing here changes that. Still, in a class action suit, the Court must remain vigilant in protecting the interests of the unrepresented class. In this role, the Court must act as a fiduciary for the absent members and must

use its own business judgment in weighing the terms of the settlement. This task necessarily requires the proponents of a settlement to submit a sufficient record. Sufficiency will be weighed on the facts of each case, but at a minimum, blatant inconsistencies should be explored and explained and adversarial assertions tested. Given the record before me, however, it appears that counsel engaged in a discovery process that was long on style and short on substance. I will not approve the Proposed Stipulation and Agreement of Comprise, Settlement and Release as presented.

IT IS SO ORDERED.