COURT OF CHANCERY
OF THE
STATE OF DELAWARE

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RE: Fort James Corp., et al. v. Jeffrey H Beck and Crown Paper Liquidating Trust
C.A. No. 19972

Dear Counsel:

This dispute arises out of a 1995 spin-off transaction. In the transaction, a parent corporation transferred assets to a wholly owned subsidiary, which became a publicly traded company and issued debt to fund the transaction. Soon after the transaction, the new company complained about its burdensome debt structure to the parent's successor, which agreed to a settlement in which it forgave part of the debt. In return, the new company released the parent's successor from potential liability connected with the transfer.

Despite the renegotiation of its debt, the new company went bankrupt. The parent's successor and the new company's liquidating trust are now before this court arguing whether litigation related to the settlement agreement should be heard in Delaware, as the contract specifies, or in California, where the federal courts are adjudicating matters related to the new company's bankruptcy. This letter opinion concludes that the disposition of the competing motions should be stayed pending the outcome of an appeal in the U.S. Ninth Circuit Court of Appeals.

A. The Spin-Off And Related Release Agreement

In August 1995, Fort James Corporation[1] and two wholly-owned subsidiaries, Crown Vantage, Inc. and Crown Paper Co. (together, "Crown"), entered into a Contribution Agreement to transfer ownership of eleven of Fort James's paper, pulp, and packaging mills (the "Spin-Off") to Crown.[2] Crown financed this purchase through a variety of devices[3]—including a $350 million secured credit facility from a bank syndicate and $250 million from a public

[1] For clarity, the court refers to James River Corporation, the predecessor, as Fort James.
[2] Cutchins Aff. ¶ 4; Harris Aff. Ex. B.
[3] The parties dispute whether the money paid by Crown to Fort James was simply a return of capital, apparently affecting whether the payment was adequate consideration. The parties do not, however, dispute that these debt structures financed the purchase. Accordingly, the court describes only the capital structure employed in the Spin-Off, and makes no findings on the adequacy of the consideration.

offering of senior subordinated notes.[4] From these proceeds, Crown paid approximately $485 million to Fort James.[5] Crown also issued $100 million in pay-in-kind twelve-year notes ("PIK Notes") due to Fort James.[6] Crown's only cash outlay for the PIK Notes was due in 2007. Any interest that accrued to the PIK Notes before 2007 were paid by the issuance of new PIK Notes. Lastly, Fort James shareholders received common stock in Crown.[7]

After the Spin-Off, Crown became a publicly traded company.[8] Soon thereafter, Crown began complaining that certain aspects of the Spin-Off created a difficult operating environment for Crown. Its principal complaint dealt with the PIK Notes. Although the PIK Notes required no cash payments until 2007, Crown complained that the PIK Notes impaired its ability to manage its capital structure.[9] As Crown's Chief Executive Officer and Chairman of the Board described, these notes were a "ticking time bomb" that impaired Crown's ability to raise new capital.[10] Furthermore, Crown complained that environmental liabilities assumed by Crown and the low tax basis on many of Crown's assets inhibited Crown's

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[4] Cutchins Aff. ¶ 4; Harris Aff. Ex. B Art. III.
[5] Cutchins Aff. ¶ 4; Harris Aff. Ex. B.
[6] Cutchins Aff. ¶ 4.
[7] Cutchins Aff. ¶ 5.
[8] *Id.*
[9] Harris Aff. Ex. A at Ex. 2; Ex. DD at 275-78, 285; Ex. EE at 483; Ex. JJ at 33, 44-45; Cutchins Aff. ¶ 8.
[10] Harris Aff. Ex. O.

ability to sell assets.[11] It also complained about exclusive output provisions arising out of post-Spin-Off transactions with Fort James.[12]

In an effort to resolve its complaints, Crown requested that Fort James reduce Crown's obligations owed to Fort James.[13] Crown believed that reducing the obligations due under the PIK Notes would create a more favorable operating environment, including a greater ease of raising new capital.[14]

With Crown in a difficult financial position, the parties began negotiating a settlement. Fort James and Crown both retained outside counsel to represent them in the negotiations. Howard Darby & Levin (currently Covington & Burling) represented Crown,[15] and Wachtell, Lipton, Rosen & Katz represented Fort James.[16] The negotiation led to the Option and Settlement Agreement on March 18, 1998.

In the agreement, Fort James agreed to forgive $33 million of the $133 million PIK Notes then outstanding and $188,910 in accrued interest.[17] Fort James also agreed to an exclusive option for Crown to purchase the remaining

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[11] Harris Aff. Ex. K.
[12] Harris Aff. Ex. Y.
[13] Harris Aff. Ex. L.
[14] *Id.*
[15] Cutchins Aff. ¶ 9.
[16] *Id.*
[17] Unless otherwise noted, facts about the agreement come directly from the Option and Settlement Agreement ("OSA").

$100 million in PIK Notes for $80 million. In addition, Fort James and Crown resolved the insurance and liability concerns raised by Crown, and Fort James agreed to terminate the exclusive output provisions from the post-Spin-Off agreements. Finally, Fort James agreed to release any claims against Crown relating to the Spin-Off.

Crown, in return, agreed to release any claims against Fort James related to the Spin-Off or related transactions. It released

> each of the Fort James Entities, and each of their past, present and future officers, directors, agents, attorney, employees, predecessors, parents, subsidiaries, affiliates and their respective heirs, executors, administrators, successors and assigns and any person or entity acting for or on behalf of, or claiming under, any of the foregoing (collectively, the "Fort James Released Parties") . . . from all actions . . . of any kind or nature whatsoever.[18]

The Settlement Agreement provides that if Crown initiates litigation and asserts "a claim, demand, cause or right of action or other matter released as a Crown Vantage Released Matter, the Fort James Released Parties sued in such litigation shall be entitled to recover . . . their reasonable attorney's fees incurred as a result of such litigation."[19]

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[18] OSA Art. II § 2.3(a).
[19] OSA Art. II § 2.3(b).

The parties also agreed to a forum selection clause. "[T]he sole forum and venue for any action or proceeding under, in connection with or relating to [the Option and Settlement] Agreement shall be the state or federal courts in Delaware."[20]

B. Crown's Bankruptcy And The Ensuing Litigation

Despite the forgiveness of some of the PIK Notes by Fort James, Crown declared bankruptcy in 2000. Crown's bankruptcy sparked an onslaught of lawsuits that have yet to resolve fully the issues between the parties.

Fort James initiated litigation against Crown in April 2001, seeking a declaration in the Bankruptcy Court for the Northern District of California that the transaction was lawful and that Fort James had no liability to Crown as a result of the Spin-Off.[21] Crown counter-claimed in September 2001, arguing that the settlement agreement was a fraudulent conveyance and therefore void.[22] In March 2002, Crown's trustee ("Trustee") filed a complaint against McGuireWoods and Crown's financial advisors, auditors, and officers and directors in the Superior

[20] OSA Art. VII § 7.5.
[21] *Fort James Corp. v. Crown Vantage, Inc. & Crown Paper Co.,* No. 02-3838 MMC (N.D. Cal.) (formerly No. 00-41584 in the Bankruptcy Court).
[22] *Crown Vantage, Inc. & Crown Paper Co. v. Fort James Corp.,* No. 02-3839 MMC (N.D. Cal.) (formerly No. 00-41584 in the Bankruptcy Court).

Court of California in Alameda County.[23] Crown's state action was then removed to the Bankruptcy Court for the Northern District of California. In April 2002, the Bankruptcy Court denied Fort James's motion to dismiss the fraudulent conveyance claim. Fort James then filed its answer in June 2002. Finally, in August 2002, the three cases (Fort James's declaratory relief action, Crown's complaint against Fort James, and the Trustee's complaint against Crown's advisors) were consolidated and transferred to the Northern District of California (the "California Litigation").

Fort James and McGuireWoods ("the plaintiffs" in this case) then filed the instant action against the Trustee and Crown's Trust ("the defendants" in this case) in October 2002 (the "Delaware Litigation").[24] In response, in March 2003, the Trustee filed a new action in the Bankruptcy Court of the Northern District of California (the "California Preliminary Injunction Action"). In that action, the Trustee sought a preliminary injunction to prevent Fort James and McGuireWoods from prosecuting the Delaware Litigation, arguing that it interfered with the Bankruptcy Court's exclusive jurisdiction and otherwise violated the *Barton* doctrine. In May 2003, this court held a hearing on the defendants' motion to

[23] *Crown Paper Liquidating Trust v. Coopers & Lybrand*, No. 02-3836 MMC (N.D. Cal.) (formerly No. 2002-043995 in the Bankruptcy Court).
[24] *Fort James Corp. v. Jeffrey H Beck*, C.A. No. 19972 (Del. Ch.).

dismiss the Delaware Litigation. After oral argument, this court decided to stay its decision pending the outcome of the District Court's[25] ruling relating to the *Barton* doctrine.[26]

In a November 2003 ruling, the Bankruptcy Court enjoined Fort James and McGuireWoods from prosecuting the Delaware Litigation, concluding that it violated the *Barton* doctrine.[27] Fort James and McGuireWoods appealed the decision. On appeal, the District Court found that the Bankruptcy Court's decision was not in error, but vacated the injunction and remanded the case for further evidentiary proceedings concerning the Trustee's likelihood of success and threat of irreparable injury.[28]

In July 2004, the Trustee appealed the District Court's ruling. Fort James and McGuireWoods then cross-appealed. The Ninth Circuit heard argument on March 17, 2005 under an expedited appeal procedure. Now the parties await the decision of the Ninth Circuit.

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[25] Looking back on the procedural posture in California, the decision that this court referred to in its oral ruling was actually the Bankruptcy Court's, not the District Court's.
[26] *Fort James Corp. v. Jeffrey H Beck*, C.A. No. 19972 (Del. Ch. May 29, 2003) (transcript).
[27] *In re Crown Vantage, Inc.*, No. 00-41584 N (Bankr. N.D. Cal. Dec. 3, 2003)
[28] *In re Crown Vantage, Inc.*, No. 04-1041 MMC (N.D. Cal. June 29, 2004)

While the parties litigated the California Preliminary Injunction Action in the Bankruptcy Court, the District Court, and the Ninth Circuit, they also moved forward in the two other strands of litigation spawned by the Spin-Off. First, in the California Litigation, Fort James and McGuireWoods filed motions to dismiss in December 2003. The District Court dismissed many counts against Fort James and all counts against McGuireWoods on the grounds of imputation/*in pari delicto*. However, the District Court refused to dismiss those counts against Fort James that were brought on behalf of Crown's creditors. Accordingly, the only remaining claims in that litigation are brought on behalf of Crown's creditors and not Crown itself.

Second, in the Delaware Litigation, this court held a hearing in February 2005 concerning a motion for fees and a motion to compel. At the end of that hearing, the defendants represented to the court that the District Court had ruled in January 2005 and that the District Court's ruling was dispositive of the issues in Delaware. In the California Action, the Trustee had moved for judgment on the pleadings based on Fort James's defense of release in the Option and Settlement Agreement. On January 12, 2005, the District Court granted the Trustee's motion, finding that Fort James cannot rely upon the release as a defense against fraudulent

conveyance claims brought by Crown's creditors.[29] The Trustee argues that fraudulent conveyance claims are left for adjudication in the California Litigation.

Since counsel did not brief the District Court's January 12, 2005 ruling (even though counsel apparently had possession of it for over three weeks), the court ordered additional briefing, including motions for summary judgment, if any, and another oral argument. That argument was held on June 10, 2005. At the hearing, the defendants argued their motion to dismiss and the plaintiffs argued their motion for partial summary judgment. This letter opinion concerns those motions.

C. Analysis

After reading the parties' briefs on their respective motions and the Ninth Circuit's oral argument transcript, this court concludes that the appropriate course of action is to stay any decision until the issues on appeal in the California Preliminary Injunction Action are resolved. "Under the so-called first-filed rule, a Delaware court typically will defer to a first-filed action in another forum and will stay Delaware litigation pending adjudication of the same or similar issues in the competing forum."[30] This principle grows out of the *McWane* case, in which the

[29] *Crown Paper Liquidating Trust v. PricewaterhouseCoopers LLP f/k/a Coopers & Lybrand*, No. 02-3836 MMC (N.D. Cal. Jan. 12, 2005).
[30] DONALD J. WOLFE, JR, & MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY, § 5-1 at 5-1 (2004 ed.).

Delaware Supreme Court stated that the staying of a later-filed action "may be warranted . . . by facts and circumstances sufficient to move the discretion of the Court [and] that such discretion should be exercised freely in favor of the stay when there is a prior action pending elsewhere, in a court capable of doing prompt and complete justice, involving the same parties and the same issues."[31] "The Court of Chancery, consistent with the directive of *McWane*, has tended to exercise its discretion liberally in favor of a stay when the prior-filed action involves the same or substantially similar parties and issues."[32]

In this case, the issue of whether Fort James and McGuireWoods should be enjoined from prosecuting the Delaware action is presently before the Ninth Circuit. Whether the Ninth Circuit enjoins them will affect, possibly in a dispositive manner, the decision of this court with regard to the motion to dismiss and the motion for summary judgment. Thus, this court agrees with the Bankruptcy Court, which said on January 5, 2005 that "the best thing to do is to see what the Ninth Circuit does and see whether we can get any clarity here."[33] The Bankruptcy Court also expressed its inclination to "just simply let this [action]

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[31] *McWane Cast Iron Pipe Corp. v. McDowell-Wellman Eng'g Co.*, 263 A.2d 281, 283 (Del. 1970).
[32] WOLFE & PITTENGER, § 5-1 at 5-3.
[33] *Jeffery H. Beck v. Fort James Corp.*, No. 04-4338 AN (Bankr. N.D. Cal. Jan. 21, 2005).

sit and stay all proceedings until [the Ninth Circuit rules]."[34] This court's decision is consistent with its earlier oral ruling that its decision should be stayed pending the outcome of a final ruling on the *Barton* doctrine by the California federal courts.[35]

In the hearing in Delaware on May 29, 2003, this court made several statements that indicated the California Preliminary Injunction Action should not be given deference as a first-filed action because it would appear to have been filed in breach of the settlement agreement between Fort James and Crown. This court maintains that, at least facially, the filing of the California Preliminary Injunction Action does appear to be a breach of the settlement agreement, but now before the Ninth Circuit is an argument that the *Barton* doctrine controls. That issue relates to the initial bankruptcy action filed before the Delaware Litigation.

The *Barton* doctrine originated in *Barton v. Barbour*, a case in which the United States Supreme Court stated that it " is a general rule that before suit is brought against a receiver leave of the court by which he was appointed must be

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[34] *Id.*

[35] Furthermore, even though at the February 2005 hearing this court ordered the parties to bring any summary judgment motions quickly, the facts surrounding the Ninth Circuit's expedited hearing were not known at that time. Now that the Ninth Circuit has expedited the California Preliminary Injunction Action, this court concludes a self-imposed stay is the better course of action.

obtained."[36] "*Barton* involved a receiver in state court, but the circuit courts have extended the *Barton* doctrine to lawsuits against a bankruptcy trustee."[37]

During the oral argument on March 17, 2005, the Ninth Circuit made several important points about the *Barton* doctrine. Most important, Judge Thomas noted the potential for conflicting judgments in this case if both the Delaware Litigation and the California Litigation are allowed to proceed simultaneously.[38] As Judge Thomas pointed out, bankruptcy is designed to avoid the very problem of multiple conflicting judgments.[39] He further stated that, if Fort James and McGuireWoods were to carry their argument to its ultimate conclusion, both on the *Barton* doctrine and the question of the administration of the estate, it would defeat the purpose of the Bankruptcy Court by allowing claimants to file claims in local jurisdictions throughout the country.[40] The final point from Judge Thomas was that bankruptcy courts control the litigation process, not vice versa.[41]

Due to the appeal of the California Preliminary Injunction Action pending before the Ninth Circuit, a decision by this court would be premature. Obviously, there is some disagreement over what jurisdiction is the correct forum in which to

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[36] 104 U.S. 126, 128 (1881).
[37] *Carter v. Rodgers*, 220 F.3d 1249, 1252 (11th Cir. 2000).
[38] Defs.' Reply Br. Ex. 1. at 13. The plaintiffs agreed, stating that "if the Delaware case goes to judgment first, that judgment is full faith and credit in California." *Id.* at 14.
[39] *Id.* at 14.
[40] *Id.* at 12.
[41] *Id*. at 15.

litigate Fort James's claims.[42] Until the Ninth Circuit decides whether Fort James or McGuireWoods can prosecute this action, this court will not rule on the motions before it.

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For the above reasons, this action is stayed until after the Ninth Circuit has ruled in the California Preliminary Injunction Action. IT IS SO ORDERED.

/s/ Stephen P. Lamb
Vice Chancellor

[42] *Compare Beck v. Fort James Corp. (In re Crown Vantage, Inc.)*, 2004 U.S. Dist. LEXIS 13807 (D. Cal. 2004) (vacating the Bankruptcy Court's injunction) *with In re Crown Vantage, Inc.*, No. 00-41584 N (Bankr. N.D. Cal. Nov. 5, 2003) (enjoining the parties before this court).