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## OF THE STATE OF DELAWARE

DONALD F. PARSONS, JR. VICE CHANCELLOR

New Castle County CourtHouse 500 N. King Street, Suite 11400 Wilmington, Delaware 19801-3734

Submitted: August 25, 2005 Decided: September 20, 2005

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> Re: Robert Y. Bonham, et al. v. HBW Holdings, Inc., Civil Action No. 820-N

## Dear Counsel:

The Court has considered Defendants' motion to stay discovery pending resolution of their motion to dismiss, the submissions of the parties and the arguments of counsel regarding the motion to stay presented on August 4 and August 25, 2005 (in the context of argument on the motion to dismiss). This is my ruling on the motion to stay.

granted within a reasonable time."4

A trial judge has discretion to determine whether or not to grant a stay of discovery.<sup>1</sup> The moving party bears the burden of proving that a stay of discovery is appropriate under the circumstances.<sup>2</sup> "[I]n each instance, the court must make a particularized judgment evaluating the weight that efficiency should be afforded (including the extent of costs that might be avoided) and the significance of any risk of injury to plaintiff that might eventuate from a stay."<sup>3</sup> The policy underlying this rule is that the "expense and time necessary for discovery may be avoided if the motion is

In this Court, absent special circumstances, discovery often is stayed pending determination of a motion to dismiss the complaint.<sup>5</sup> Chancellor Allen's decision in *In re McCrory* articulates three "special circumstances" that may justify denying a stay of discovery despite the pendency of a motion to dismiss. Those circumstances are: (i) where the motion does not offer a "reasonable expectation" of avoiding further litigation,

Orloff v. Shulman, 2005 WL 333240, at \*1 (Del. Ch. Feb. 2, 2005).

<sup>&</sup>lt;sup>2</sup> *Id*.

<sup>&</sup>lt;sup>3</sup> In re McCrory, 1991 WL 137145, at \*1 (Del. Ch. July 3, 1991).

<sup>&</sup>lt;sup>4</sup> Stotland v. GAF Corp., 1983 WL 21371, at \*3 (Del. Ch. Sept. 1, 1983).

Greenspan v. Hinrichs, 1998 WL 83047, at \*1 (Del. Ch. Feb. 10, 1998) (quoting In re McCrory, 1991 WL 137145, at \*1).

(ii) where the plaintiff has requested interim relief, and (iii) where the plaintiff will be

prejudiced because "information may be unavailable later."

In this case, at least one of these special circumstances exists as to each count of

the Complaint, albeit to varying degrees. First, the motion to dismiss does not offer a

reasonable expectation of avoiding further litigation over a number of disputes

underlying the various counts. In addition, Plaintiffs' requested relief involves elements

of exigency analogous to a claim for interim relief in that they seek release of the

\$25 million from escrow at the earliest possible time.

Based on these factors and my preliminary view that Defendants' motion to

dismiss, which remains under advisement, is unlikely to resolve all of Plaintiffs' claims, I

GRANT IN PART and DENY IN PART the motion to stay discovery as follows:

1. As to Plaintiffs' claims relating to Defendants' state and local tax

("SALT") claims, the motion to stay discovery is denied to the extent the discovery

relates to the adequacy of notice of Defendants' claim under the Stock Purchase

Agreement ("SPA") § 7.6 and the Escrow Agreement ("EA") § 3(b), including without

limitation the level of specificity required in such a notice, whether the applicable

agreements require a written assessment of taxes by a governmental authority, the extent

to which any SALT claims against HBW had been asserted, threatened, alluded to or

otherwise communicated by any governmental authorities as of November 4, 2004 (the

In re McCrory, 1991 WL 137145, at \*1; Orloff, 2005 WL 333240, at \*1.

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date of the last notice letter), and if so, the nature and amount of such claims, and any

other facts upon which Defendants might rely to demonstrate the existence of such SALT

claim as of November 4, 2004; Defendants' motion to stay discovery as to the SALT

claims is GRANTED as to any and all discovery directed to the merits of any SALT

claim upon which Defendants' notice of claim may have been based and whether the

SALT claim is a "tax claim" and therefore arbitrable. The Court grants a stay of that

discovery at this time because there appears to be a reasonable probability that the merits

of the SALT claims will need to be addressed in arbitration and the scope of discovery in

arbitration may be significantly different from the discovery that would be available in

this Court. In addition, for this and the other counts of the Complaint, Plaintiffs' claims

of exigency relate primarily to their contention that Defendants improperly caused the

escrow period to be extended by filing notices of claims that did not meet the

requirements of the applicable agreements.

2. As to Plaintiffs' claims related to Defendants' unclaimed property

claims, the motion to stay discovery is denied to the extent the discovery relates to the

adequacy of notice of Defendants' claims under SPA § 7.6 and EA § 3(b), including

without limitation the level of specificity required in such a notice, whether the applicable

agreements require a written assessment of taxes or unclaimed property liability by a

governmental authority, the extent to which any unclaimed property claims against HBW

had been asserted, threatened, alluded to or otherwise communicated by any

governmental authorities as of November 4, 2004 (the date of the last notice letter), and if

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so, the nature and amount of such claims, and any other facts upon which Defendants

might rely to demonstrate the existence of such unclaimed property claim as of

November 4, 2004; the motion to stay is also denied to the extent the discovery relates to

whether the unclaimed property claim is a tax claim within the meaning of the applicable

agreements and therefore subject to arbitration; Defendants' motion to stay discovery as

to the unclaimed property claims is GRANTED as to any and all discovery directed to the

merits of any such claim upon which Defendants' notice of claim may have been based.

The Court denies the stay of discovery as to whether an unclaimed property

claim is a tax claim because it appears that the Court would benefit from further

development of the facts and law related to that issue. The Court grants a stay of

discovery as to the merits at this time because there appears to be a reasonable possibility

that the merits of the unclaimed property claims will need to be addressed in arbitration

and the scope of discovery in arbitration may be significantly different from the

discovery that would be available in this Court.

3. As to Plaintiffs' claims relating to Defendants' financial

misstatement claim for in excess of \$25 million, the motion to stay discovery is denied to

the extent the discovery relates to the adequacy of notice of Defendants' claim under SPA

§ 7.6 and EA § 3(b), including without limitation the level of specificity required in such

a notice in terms of the amount of damages, any facts upon which Defendants might rely

to demonstrate the basis for their estimate of an amount of damages in excess of

\$25 million as of November 4, 2004; the motion to stay is also denied as to any and all

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discovery directed to the merits of the claim for financial misstatements upon which

Defendants' notice of claim may have been based.

The Court denies the stay of discovery on the merits in this instance

because this Court has acknowledged that discovery should not be delayed "[i]f discovery

is inevitable, either in this forum or another." A stay in such circumstances would not be

efficient because the parties would be obligated under the authority of another forum to

continue with virtually the same discovery.8 In this case, Defendants recently filed

litigation in federal court in Delaware raising essentially the same financial misstatement

claim that gave rise to Plaintiffs' Complaint. In such a situation, the plaintiff may defeat

a motion to stay by showing that a stay would potentially increase the discovery work

necessary for the parties to litigate their disputes.<sup>9</sup> I believe that possibility exists here

and, more importantly, that Plaintiffs efforts to expedite resolution of these disputes

would be needlessly thwarted by a stay on the merits of the misstatement claim.

Furthermore, I do not consider the differences between discovery in the District Court

and the Court of Chancery significant enough to create any material likelihood of

wasteful disputes or unnecessary expense. I would expect the parties to agree that

discovery provided in one case can be used in the other subject to an appropriate

Skubik v. New Castle County, 1998 WL 118199, at \*3 (Del. Ch. Mar. 5, 1998).

<sup>8</sup> Id.

Id.

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protective order. If no such agreement can be reached, either party may seek relief as

they deem appropriate.

4. The Court grants a stay of discovery as to any challenge to the

adequacy of the specificity of the notice as to the nature of the financial misstatement

claim based on Plaintiffs' acknowledgement of the adequacy of the notice in that regard.

5. As to Plaintiffs' claims based on HBW's alleged misallocation of

\$27 million of the purchase price to the noncompetition agreement, the motion to stay

discovery is denied to the extent the discovery relates to whether the parties reached any

agreement in connection with the SPA or related agreements regarding how the purchase

price was to be allocated or what portion, if any, of the consideration was to be allocated

to the noncompetition agreement. Defendants' motion to stay discovery is granted,

however, to the extent the requested discovery relates to determining the value of the

noncompete agreement, through use of experts and other valuation means, or to the tax

consequences of any specific allocation.

This Court has jurisdiction to determine whether the parties agreed upon

any allocation of the purchase price, including as to the noncompetition agreement.<sup>10</sup>

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See Stern & Co. v. State Loan & Fin. Corp., 205 F. Supp. 702, 705-06 (D. Del. 1962); Mastan Co. v. Jackson, 321 F. Supp. 865, 867 (N.D. Ill. 1971)("Although damages in this action will be directly affected by the ultimate determination of

the plaintiff's tax liability by the I.R.S., this action is one for breach of warranties and fraud in the sale of securities and corporate assets. This is not an action to confer tax liability upon the defendants."); *King v. United States*, 390 F.2d 894,

914 (Ct. Cl. 1968)("Quite obviously the plaintiff is interested in the tax consequences of his retirement rating. But that does not make it an action with

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Defendants dispute this conclusion, arguing that this is a tax dispute that does not fall

within the jurisdiction of this Court. Even though Plaintiffs' claim may have tax

consequences, the interpretation of the contract as to how much consideration is given to

each aspect of the transaction falls within this Courts jurisdiction.

In Stern, the defendant argued that pursuant to the Declaratory Judgment

Act, 28 U.S.C. § 2201, the court did not have jurisdiction to issue declaratory relief

because the controversy was a federal tax dispute, and such disputes are specifically

exempted from the scope of the Declaratory Judgment Act. 11 The Stern plaintiff

countered that the claim was not "with respect to taxes" and was nothing more than "an

alleged breach of contract by the other contracting party, which breach plaintiff claim[ed]

[would] result in serious consequences of a tax nature to it." In specifically rejecting

the defendant's argument that the action concerned federal taxes, the *Stern* court held that

while "[t]his court may not determine tax liability; it may determine facts which may

have a direct, even immediate, bearing on what the tax liability will be." The court

further held that "[t]he fact that plaintiff has 'tax motives' for bringing this suit to

respect to federal taxes. The determination which plaintiff requests is not a determination of his tax liability; [but] the interpretation and application of Int. Rev. Code of 1954 § 104(a)(4). In the[se] circumstances, [the plaintiff's] tax motives have absolutely no bearing"); *Henderson v. Croom*, 403 F. Supp. 665, 667 (N.D. Ala. 1975).

<sup>11</sup> Stern, 205 F. Supp. at 704-05.

<sup>12</sup> *Id.* 

13 *Id.* at 706.

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determine rights of parties under their contract cannot squeeze this action into the

statutory exception by virtue of depriving this Court of jurisdiction."<sup>14</sup> Therefore, this

Court has jurisdiction to determine how the parties agreed to allocate the consideration (if

at all) in the Arias/HBW transaction.

6. Defendants' motion to stay discovery is granted to the extent the

discovery relates to Defendants' subjective state of mind or to Plaintiffs' allegations of

bad faith as to the SALT claim, the unclaimed property claim and the Defendants'

allocation of \$27 million to the noncompetition agreement. I have concluded that it

would be more efficient and serve the interests of justice to defer discovery on those

issues until after the motion to dismiss has been resolved.

7. Based on the foregoing rulings and to the extent the motion to stay

has been denied, Defendants shall respond to the outstanding written discovery

propounded by Plaintiffs within 15 days of the date of this Letter Opinion and Order.

IT IS SO ORDERED.

Sincerely,

/s/Donald F. Parsons, Jr.

Vice Chancellor

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Id.