COURT OF CHANCERY
OF THE
STATE OF DELAWARE

JOHN W. NOBLE
VICE CHANCELLOR

417 S. STATE STREET
DOVER, DELAWARE 19901
TELEPHONE: (302) 739-4397
FACSIMILE: (302) 739-6179

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L. Vincent Ramunno, Esquire
Ramunno, Ramunno & Scerba, P.A.
903 North French Street
Wilmington, DE 19801-3399

Jeffrey M. Weiner, Esquire
Law Offices of Jeffrey M. Weiner, P.A.
1332 King Street
Wilmington, DE 19801

Re: Ramunno v. Capano, et al.
C.A. No. 18798-NC
Date Submitted: August 17, 2005

Dear Mr. Ramunno and Mr. Weiner:

Plaintiff L. Vincent Ramunno (the "Trustee") serves as the trustee of four trusts which collectively held a 12.1% interest in Nominal Defendant Augustine Land Limited Partnership ("Original Augustine"), a Delaware limited partnership. On March 21, 2001, Defendants Louis J. Capano, Jr. ("Louis") and Joseph M. Capano ("Joseph"), who held a majority of the equity interests in Original Augustine, caused its merger into a new partnership, Nominal Defendant Augustine Land I L.P. ("Second Augustine"), a Delaware limited partnership controlled by them. That merger extinguished the interests of the trusts in Original Augustine. The parties disagree over the fair value to be paid to the trusts for their interests in Original Augustine. In this post-trial letter opinion, the Court resolves that debate.

I.

Brothers Thomas J. Capano ("Thomas"), Joseph, and Louis formed Original Augustine in late 1988.[1] They held their interests as limited partners. The general partner, Defendant Mardi Gras Associates, Inc. ("Mardi Gras"), is a corporation controlled by Louis.[2] A fourth brother, Gerard J. Capano ("Gerard"), joined the venture, also as a limited partner, as of January 1, 1989.[3]

In early 1989, Original Augustine acquired the Wanamaker's Building and its 16.7 acre site on Augustine Cut-Off north of Wilmington, in New Castle County, Delaware (the "Property") for a purchase price of approximately $12,150,000. Funding for the acquisition was accomplished through a mortgage

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[1] The Limited Partnership Agreement (the "Partnership Agreement") for Original Augustine appears as PX 33.
[2] Louis was the initial general partner. Mardi Gras was substituted as of February 24, 1989. DX 2.
[3] PX 34. Louis and Joseph would acquire Gerard's interest in 1994.

($9,990,000) and capital contributions from the four partners (approximately $3,500,000).

Wanamaker's vacated the building in early 1992 and, of course, its rental payments ceased. It would be five years before a new tenant would be found. The site also included a tire store which generated annual rental income of less than $140,000. Thus, in order to meet Original Augustine's debt service requirements, the four limited partners each paid in approximately $400,000 as additional capital.

In September 1992, Westwoods Development, Inc. ("Westwoods"), a corporation owned by Louis and Joseph, loaned Original Augustine $2,000,000.[4] No note evidencing that indebtedness has been found.[5] As of December 1992, the Westwoods loan had a balance of $1,015,214.60.

From 1993 through 1996, the only income received by Original Augustine was the tire store rental. Louis, Joseph and Thomas made capital contributions of approximately $2,700,000. No payment, however, was made on the loan from Westwoods and, as of December 31, 1996, Westwoods determined its loan to

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[4] Thomas was aware of this loan. Westwoods had borrowed the money from Wilmington Trust Company. DX 91.

[5] The records of Westwoods and Original Augustine contain matching entries reflecting the Westwoods loan. DX 96; DX 97. There is insufficient evidence to conclude that a note was executed but was later lost.

Original Augustine to be a "non-business bad debt-uncollectible note receivable."[6] Westwoods, for tax purposes, treated the loan write-off as a short-term capital loss.[7] The tax records of Original Augustine reflected the Westwoods loan as a reduction in the cost basis of the improvements on the site.

In 1997, Louis and Joseph each contributed more than $800,000 in additional capital. Thomas should have contributed $402,874.36 as his proportionate share. He contributed nothing.

Original Augustine, on June 27, 1997, entered into a ten-year lease with Andersen Consulting LLP ("Andersen Consulting"). Rental payments commenced in December 1997, but full occupancy under the lease (and, thus, full rental payments) would not occur until October 1, 1998. With Andersen Consulting's exercise of its expansion option, the Wanamaker's Building is fully leased through 2007.

Beginning in 1991, Thomas regularly gave limited partnership interests in Original Augustine in trust to his four children. Those gifts initially were made to

[6] The total of principal and interest due at that time was $1,260,247.
[7] DX 98.

Kathleen M. Ryan ("Ryan"), his then-wife, as trustee for their children.[8] Later on, Thomas transferred the balance of his holdings in Original Augustine to the Trustee for the benefit of his children.[9] The Trustee held a 12.1% interest in Original Augustine as of March 21, 2001. By then, all of Thomas's interest in Original Augustine had been assigned to the trustees. Transfers to the trustees for his children amounted to a 22.5% interest.[10]

On March 21, 2001, Second Augustine was formed. Mardi Gras was designated as its general partner. The limited partners were Louis, Joseph, and L III Holdings, L.L.C. ("L III"), a Delaware limited liability company owned by Louis and his son, Louis J. Capano, III.[11] By the Merger Agreement (the "Merger"),[12] dated as of March 21, 2001, Original Augustine was merged into

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[8] Between 1991 and 1999, a 10.4% interest in Original Augustine was transferred to Ryan, as trustee. Ryan joined the Trustee in bringing this action. She settled her claims during trial. As between Ryan and the Trustee, the Trustee held 53.78% of the trusts' interests. DX 40

[9] The transfers to the Trustee were in 2000.

[10] The Partnership Agreement, as amended, reflects, for Thomas, a 22.5% interest in the income and a 25% equity interest. DX 3. The tax returns in the several years leading up to this dispute show a 22.5% interest, which is the interest upon which the Court relies, in part because it was acquiesced in by the parties and Thomas. DX 14. For convenience, the percentage interest of Mardi Gras, Joseph, and Louis (including L III), are treated as a collective holding because of their commonly-shared interests in this litigation. Thus, their share, for purposes of the calculations made in this letter opinion, is 77.5%.

[11] By January 1, 1998, Louis had assigned a portion of his interest in Original Augustine to L III.

[12] DX 18.

Second Augustine. The Trustee (and Ryan for that matter) was not advised of the merger plans in advance. Notice was given by letter dated March 23, 2001.[13] The effect of the Merger was to "freeze out" the interests held in trust for the benefit of Thomas's children.

The defendants offered Ryan and the Trustee a total of $500,000 for the trusts' interests in Original Augustine. The Trustee's 12.1% interest in Original Augustine was valued by the defendants at $268,889. The Trustee did not accept payment at that time. Later, he accepted a total of $66,666 from the defendants.[14]

Although not similarly reflected on Original Augustine's financial statements before the Merger, Second Augustine's 2002 financial statement showed the Westwoods loan as a note payable on demand, with a principal balance of $1,015,214 and a 7% interest rate; its tax returns reflected the Westwoods loan as a debt payable in less than one year.[15] From 1992 until the Merger in March

[13] DX 20. The defendants offered three reasons for this action: (1) animosity between the Trustee and the individual defendants; (2) that capital calls would occur in the future and it was unlikely that the trusts would have the funds to meet them; and (3) that Andersen Consulting had stated that it would not renew its lease on expiration in 2007, thus dimming the prospects for any significant income distribution to the trusts over the next decade. DX 23.

[14] On June 19, 2002, the defendants paid the Trustee $33,333, and, on December 31, 2002, they paid an additional $33,333. DX 109; DX 110.

[15] Thus, the books of Original Augustine, as of the date of the Merger, did not set forth an indebtedness to Westwoods.

2001, no payment was made on the Westwoods loan and no demand for payment or other effort to collect the debt was made.

II.

Louis and Joseph argue that they owed no fiduciary duties to the Trustee because he was a mere "assignee" of a limited partnership interest and not a limited partner.[16] The Partnership Agreement generally prohibited transfers of partnership interests without the consent of the general partner and a majority of the limited partners. However, intra-family transfers were allowed by Section 13.1(C) which provided in part:

> Anything in this Agreement to the contrary notwithstanding, a Partner, during his lifetime, may at any time or from time to time transfer all or any part of his Partnership Interest to one or more of his children . . . or to a trustee for the exclusive benefit of . . . one or more of his children . . . (all of which are hereinafter referred to as "Related Partners"); . . . provided, however, that any Related Partner receiving a Partnership Interest shall become a signatory hereto by executing a conformed counterpart of this Agreement whereby such person . . . shall be deemed to have adopted and to have agreed to be bound by all provisions of this Agreement.

[16] By 6 *Del.C.* § 17-702(a)(2): "Unless otherwise provided in the partnership agreement, . . . [a]n assignment of a partnership interest does not . . . entitle the assignee to become or to exercise any rights or powers of a partner."

The Trustee, as trustee, never executed a conformed counterpart of Original Augustine's Partnership Agreement.

Original Augustine's tax returns for 2000 (prepared after the Merger) expressly noted that Ryan, who had been assigned partnership interests earlier, and the Trustee were assignees of limited partnership interests and not limited partners.[17] Earlier returns for almost a decade show Ryan as a limited partner without any such reservations.[18] Although the execution of a counterpart of the Partnership Agreement is a requirement imposed when the Partnership Agreement was negotiated,[19] Ryan was treated as a limited partner without ever executing the agreement, the limited partners understood that each could freely assign his interests to family members,[20] and Louis and Joseph never raised the issue until after this dispute arose. I conclude, therefore, that the defendants waived the right to contest the Trustee's status as a limited partner.[21] Thus, the Trustee is entitled to

[17] DX 14(m).
[18] *E.g.*, DX 14(l) (Original Augustine's 1999 partnership tax return).
[19] The defendants suggest that the Trustee's decision not to execute the Partnership Agreement may have been a tactical decision to avoid potential liability for capital calls.
[20] Louis transferred roughly half of his limited partnership interests in Original Augustine to L III in 1997. DX 5. That was accomplished without approval by the other limited partners and without execution of a partnership agreement counterpart.
[21] "'Waiver is the voluntary relinquishment of a known right or conduct such as to warrant an inference to that effect. It implies knowledge of all material facts and of one's rights, together with a willingness to refrain from enforcing those rights.'" *Delaware Express Shuttle, Inc. v.*

those fiduciary duties conferred by law and the Partnership Agreement on Original Augustine's limited partners.[22] Although I conclude that Louis and Joseph owed the Trustee, as a limited partner, fiduciary duties, it is a conclusion without much importance, in this context, because the defendants concede that the Court may determine the "fair value" of the Trustee's interest, a description of the Court's task with which the Trustee agrees.[23]

Older, 2002 WL 31458243, at *10 (Del. Ch. Oct. 23, 2002) (quoting *Klein v. Am. Luggage Works, Inc.*, 158 A.2d 814, 818 (Del. 1960)); *see also Tristate Courier & Carriage, Inc. v. Berryman*, 2004 WL 835886, at *9 n.123 (Del. Ch. Apr. 15, 2004).

[22] Thomas, in compliance with the terms of the Partnership Agreement, could have transferred his interest to virtually anyone as trustee for his children and that trustee could have become a limited partner merely through the ministerial act of executing a counterpart to the agreement. Nothing in the Partnership Agreement allowed the other limited partners to veto a designated trustee for family members. Because of the relationship Louis and Joseph had with the Trustee, one can understand (without assessing responsibility for the nature of that relationship) why Louis and Joseph were not enthusiastic about the Trustee's becoming a limited partner. Those relationship concerns—however important they might be to the effective functioning of a venture—were not addressed in the Partnership Agreement.

[23] The only claim of substance where notions of fiduciary duty might have an influence in the outcome involves the treatment of the Westwoods loan. The principles guiding the Court's function in determining fair value, with respect to that aspect of this valuation effort, implicitly, if not explicitly, include the concepts of fair dealing by the defendants. Louis and Joseph have not argued that, if they did not owe fiduciary duties to the Trustee, they could not be held liable for payment of fair value. Indeed, because they acknowledge that, with the valuation which they sponsor, additional sums will be due, they concede that judgment should be entered against them. They, of course, dispute the amount.

The Trustee also alleged that Louis breached his fiduciary duties to Original Augustine in the course of a construction project for Original Augustine by a company controlled by Louis. The Trustee failed to develop the claim in a manner sufficient either for Louis to be called upon to justify his actions or for the Court to rule upon the claim.

III.

The fair value debate focuses upon three topics: (1) the fair value of the Property; (2) the appropriate rate of interest to be charged against the shortfall in Thomas's capital account; and (3) the proper treatment of the Westwoods loan.

A.

The Property was appraised, as of August 12, 1997, by Gary V. Parker ("Parker"), an experienced real estate appraiser who performed his appraisal for an independent third party, and whose appraisal was near the time of commencement of the ten-year lease with Andersen Consulting. That provides the most stable foundation for analyzing the value of the Property. Parker's appraisal relied upon both the income capitalization methodology and the sales comparison methodology. Parker's valuation, because it was premised upon the 100% occupancy provided by Andersen Consulting, is applicable as of October 1, 1998, when full occupancy was achieved. Parker appraised the Property under those conditions at $22 million.

The rent would increase at approximately 2% per year, but, to an extent, the projected increase in rent under the Andersen Consulting lease was considered by Parker in his income capitalization. Both the defendants and the Trustee presented experts to assist the Court in establishing fair value of the Property. I accept the conclusions of the defendants' expert, Geoffrey M. Langdon, who projected that an inflation rate of 3% was reasonable and that the inflation rate was a reasonable measure for projecting the increase in value of the Property over a less than three-year period. Accordingly, with the $22 million appraisal as of October 1, 1998, escalated at 3% to March 31, 2001, the fair value of the real estate becomes $23,711,232.[24]

The intense debate between the parties is not about the proper methodology for escalating Parker's appraisal. Instead, the Trustee urges that the Court conclude that the Property had substantial development potential. This development could take the form of additional office space or, perhaps, retail

[24] The Trustee does rely upon discounted cash flow analyses performed by Peter J. Winnington, C.P.A. *See* PX E, F & G. Winnington, who concedes that he is not a real estate expert, Tr. 518, was assisted, to some not very specific extent, by Robert H. McKennon, an experienced real estate appraiser. As McKennon put it, Winnington's assumptions were aggressive, especially as to the occupancy of the Wanamaker's Building after the Andersen Consulting lease expires in 2007. Tr. 744. That and other questionable assumptions (such as the cost of insurance, Tr. 490-92; real estate taxes, Tr. 487-90; increases in leasing commissions, Tr. 495; and additional costs that might become the landlord's responsibility in 2008) undercut the helpfulness of his analyses. Even with their flaws, Winnington's analyses form a range within which the extrapolated Parker analysis falls. Moreover, McKennon's admittedly informal, initial assessment of the value of the Property concluded that "you're probably looking at a property that could be worth $22 to 23 million." Tr. 734. That, of course, is consistent with a value of $23.7 million, based upon an extrapolation of the Parker appraisal.

space; if the Property could accommodate additional rental areas, then, even the defendants concede, the Property's value would be substantially enhanced. The Trustee suggests that this increase in value could be by, perhaps, $2 million; the defendants maintain that, under any scenario, the increase in value would be substantially less than that.

In seeking to value the Property as of the Merger, evaluation of the potential for additional office space raises two questions: First, was the construction of additional improvements something that Original Augustine would consider and would be able, as a matter of skill, experience, and resources, to implement? Second, was it likely that the necessary governmental approvals could be obtained for the construction of additional office space (or, perhaps, retail space)? The Court, thus, must ascertain whether there was, as of March 2001, a reasonable probability that Original Augustine could profitably develop additional office space on the Property.

It is clear that Original Augustine had considered the potential for additional construction on the parcel almost from the time it was acquired.[25] At one time,

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[25] *See, e.g.*, DX 66.

very rough plans for an expansion were prepared.[26] In 1999, Original Augustine gave preliminary consideration to developing a 20,000 sq. ft. office building,[27] but nothing came of that effort. At another time, a realtor listed the parcel as available for the construction of additional office space.[28] The limited partners of Original Augustine were experienced developers of real estate in New Castle County, Delaware and had the capacity to implement such a project.

The more difficult inquiry is whether expansion was feasible, when viewed as of March 21, 2001, the time of the Merger. More specifically, the question becomes one of whether the potential of additional development was so speculative or uncertain that it could not reasonably be accommodated in any projection of value. It is not that development was impossible; it is not that, at some indefinite

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[26] PX 72. New construction was probably unlikely while Original Augustine was searching for a new tenant for the Wanamaker's Building.
[27] *See* DX 68.
[28] Louis contends that the listing was a mistake. An advertising circular supporting the listing offered: "The Wanamaker Build-to-Suit Site—Build to Suit Opportunity for 100,000± sq. ft." PX 67. The listing agreement was signed by Louis's son who had had no prior involvement with the Wanamaker's site. The parties dispute whether that was a mistake. (The realtor testified that it was a mistake. Tr. 1213-16; *see* PX 66.) It is not necessary to resolve the dispute, in part, because nothing ever resulted from it. It simply confirms that Original Augustine considered development. It provides no guidance on whether the necessary approvals could have been obtained.

time well into the future, development might have become possible.[29] Instead, the limitations on the ability of the partnership to develop the real estate in March 2001 and in the next several years thereafter must be assessed.

Based on the record before the Court, the likelihood of approval of the construction of additional office space on the Property was so unlikely that it could not serve as a basis for enhancing the value of the parcel. First, the lease with Andersen Consulting guaranteed it so much parking that there would be no excess space that would allow for development. Second, the existing improvements constituted a nonconforming use and additional improvements could not be constructed in compliance with New Castle County's Unified Development Code (the "UDC"), its zoning ordinance. For example, in early February 2001, Original Augustine's counsel wrote to Original Augustine's engineering firm, Karins & Associates, and asked it to "determine the allowable square footage of development under the existing OR zone" and under a possible rezoning of the

[29] If development well into the future were, at least likely, it would add little to the value of the Property because of the "time value" in any benefits of such development. Also, the further into the future the analysis goes, the more speculative it becomes.

parcel to CN.[30] The engineer analyzed the Property and its potential for development and concluded that "no additional building is permitted without a variance."[31] The site could not satisfy the County's landscaping area requirements.[32]

The Trustee suggests that either a variance or another approach, such as authorization of a proportional expansion of a nonconforming use, could be achieved. I also find that the obtaining of a variance (or other approval) needed for additional development was unlikely. Approvals may have been possible—but only in the unhelpful sense of "anything is possible." Perhaps the most persuasive evidence was provided through a letter written to the Trustee by his land use expert, William T. Wichess, PLS, in which he opined:

> Regarding the possibility of obtaining a variance as to the open space and other design elements required to support the additional office

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[30] DX 69. The inquiry was prompted by Joseph, who, while attending a New Castle County Council meeting on another matter, learned that the County was considering rezoning the Property from OR to CN.

[31] DX 70. This conclusion was reported by letter, dated March 19, 2001.

[32] The engineer's concurrency calculations showed that the site, but for the landscaping requirements, could accommodate significant additional office space. I accept Karins' conclusions.

> space it is my opinion that if the site could be brought into compliance and we could not demonstrate undue hardship this would have less than a 50% chance of success.[33]

In sum, there is no sufficient basis for enhancing the value of the Property based on the potential for additional construction.[34] Accordingly, for purposes of determining fair value of Original Augustine as of the Merger, the Property is assigned a value of $23,711,232.

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[33] DX 86. The need for a variance does not necessarily lead to the conclusion that development is not likely. There, of course, are instances in which land use professionals can predict, with a degree of confidence, that it is reasonable to expect a variance or other necessary land use approval. None of the experts, in the Court's view, however, testified with any degree of confidence that approval could reasonably be expected.

[34] In reaching this conclusion, I rely, in addition to other evidence, upon the opinions expressed by William J. Rhodunda, Jr., Esquire, a former New Castle County Attorney and experienced land use practitioner. He expressed the opinion that it was not probable that a variance could be obtained for the Property. Tr. 1089. He predicted that nearby residential communities would vigorously oppose any such request, especially because of potential traffic issues, and pointed out that community opposition is frequently a significant factor in the decision to grant or deny a variance. Also, because only the most preliminary of concepts for development had been proposed—either by the partnership's or by the Trustee's experts, it was difficult to appreciate fully all of the obstacles that might be encountered (or variances that might be required). Rhodunda also reviewed the mix of practical and regulatory challenges that any substantial development would likely confront. The site was short about an acre in open space. Stormwater management requirements had changed over time, and the topography of the site (open space at a significantly higher elevation than the Wanamaker's Building) would pose additional problems. Tr. 1092. Finally, he reflected on the Trustee's suggestion that additional construction might be possible under that portion of the UDC that authorizes proportional expansion of nonconforming sites. He first noted that, since adoption of the UDC, the proportional expansion provisions, as far as he knew, had not been used to authorize construction of a stand-alone building, Tr. 1098, and he predicted that satisfying the County would be difficult, at best. He next observed that, without further development of a project scope, any assessment of its likelihood for approval would be "pure speculation." Tr. 1104.

B.

Thomas failed to make a capital contribution in 1997 of $402,874.[35] That failure has not been cured. That shortfall in his capital account carries through to the capital accounts of the trusts and must be included in any calculation to determine the value of the trusts' interests in Original Augustine. The parties disagree as to the interest rate to be charged on the capital account shortfall. The Trustee suggests a 7% interest rate, which he contends is essentially "prime plus 1%."[36] An interest rate of 7%, however, would not fairly account for the venture risk to which the partnership's assets were exposed. Indeed, it is fundamentally unfair for one partner to benefit from his other partners placing their funds at risk, while that partner holds on to his own funds.[37] Although in 1997 Original Augustine had finally rented the Wanamaker's Building to Andersen Consulting, it remained an investment with a risk profile that supports a rate of

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[35] Capital calls are addressed by Section 18 of the Partnership Agreement.

[36] The defendants assert that "prime plus 1%" for the relevant period would be closer to 10%. *See* DX 205.

By Section 11.1 of the Partnership Agreement, loans to Original Augustine by its limited partners are to bear interest at a rate of 1% above Wilmington Trust Company's prime rate. The Trustee argues that this establishes the interest rate on the shortfall in Thomas's capital account. It does not because the shortfall is not a loan and because the capital contributions of the limited partners that gave rise to the capital account shortfall are just that: capital contributions.

[37] *See Cole v. Kershaw*, 2000 WL 1206672, *12 (Del. Ch. Aug. 15, 2000).

interest well above prime. Parker, in his 1997 appraisal, assessed the risk and the cost of capital of the venture by setting a discount rate of 11.25%. This number was established well-before this litigation and, in substance, was accepted by the partnership. I am satisfied that it is a reasonable accommodation of the various risks to which the venture was exposed and an accurate measure of Original Augustine's effective cost of capital. Nothing occurred in the interim that would have materially altered the risk profile. Accordingly, Thomas's capital shortfall will bear interest at an annual rate of 11.25%, compounded monthly, from July 1, 1997 until the Merger.[38]

In 2000, Original Augustine distributed $225,000 to Louis and $150,000 to Joseph. With a 22.5% interest, Thomas should have received $106,875.[39] He was the beneficiary of a $75,000 payment to his lawyer;[40] that leaves the balance of

[38] Louis and Joseph made several contributions during the year. DX 104 & 105. The middle of the year is a reasonable starting point for the necessary calculations.

[39] Based on the evidence before it, the Court would calculate a slightly different amount ($108,871). The parties have accepted $106,875, as will the Court.

[40] DX 108. Thomas was a defendant in a criminal proceeding. At his mother's request, but apparently without his express confirmation, the partnership paid $75,000 to a law professor to assist with his defense. The defendants seek to treat that as a payment to him and, thus, as a reduction in any amount that may be due to the trusts, as his assignees or successors. The trustee argues that Thomas never requested or approved the payment. The payment will be treated as a distribution to Thomas. It was for his benefit; he received the benefit; the defendants acted reasonably in making the payment.

$31,875 in distributions owed to him in 2000. In 1999, Louis and Joseph received distributions from Original Augustine in the combined amount of $50,000. That suggests a total capital distribution to all partners of $64,516. Thomas received no distribution but should have been credited with $14,516 against his capital account deficiency. These amounts should be applied against his capital account shortfall. Using July 1 as a reasonable date for consolidated treatment of the distributions, Thomas (and those claiming through him) suffered a capital account shortage calculated as follows:

Period	Shortfall (Credit)	Interest
July 1, 1997 to March 21, 2001	$ 402,874	$ 208,325
July 1, 1999 to March 21,2001	(14,516)	(3,088)
July 1, 2000 to March 21, 2001	(31,875)	(2,685)
	$ 356,483	$ 202,552

Thus, Thomas's total capital account deficiency (shortfall plus interest) is $559,035.[41] The share allocable to the trusts for which the Trustee is the fiduciary is $300,637.

C.

In 1992, Westwoods, a company controlled by Louis and Joseph, borrowed $2 million from Wilmington Trust Company and loaned it to Original Augustine. With the release of escrow from the financing for a construction project and other transfers, the balance on that loan was reduced to $1,015,214.60 by the end of 1992.[42] The loan to the partnership is not evidenced by any note. Original Augustine's financial statements and tax returns for the years 1992 through 1996 do reflect the loan and confirm that the debt exists.[43] Thus, even though the loan was not properly documented, the funds were received by the partnership and the partnership was obligated to repay the debt to Westwoods.

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[41] This does not include the consequences of the Westwoods loan.

[42] DX 95.

[43] Interest on the Westwoods loan was accrued at 7% by Original Augustine. The 7% interest rate approximated both the market rate and the interest charged to Westwoods by Wilmington Trust. Thomas was aware of the interest accrued and did not object to it. Moreover, the interest rate charged is not inconsistent with the "prime plus one" rate set forth in Section 11.1 of the Partnership Agreement for loans by partners to the partnership.

In 1996, Louis and Joseph, together with their advisers, decided to "write off" the balance[44] and to take a bad debt deduction on their personal tax returns.[45] Thereafter, the Westwoods loan disappeared from the Original Augustine's books. After the Merger, it reappeared in Second Augustine's books. Louis and Joseph have asked the Court to treat it as a partnership debt in determining the proper value of trusts' interests. The Trustee argues that once the loan was "off the books," Louis and Joseph could not simply reenter it for their exclusive personal benefit. In short, the Trustee accuses Louis and Joseph of breaching their fiduciary duties and of acting in their own self-interest. The Trustee also argues that any effort to collect the debt was barred by the statute of limitations and that Louis and Joseph could not waive that defense without breaching duties owed to the trusts.

Debts evidenced by a note may be subject to either a six-year statute of limitations or a ten-year statute of limitations.[46] Debts which are "not evidenced

[44] Writing off a debt for tax purposes does not demonstrate that the debt obligation does not exist. More importantly, it does not prove that the debt obligation is not an asset because the "write off" of a debt is not the equivalent of a release of the debt. It is simply an accounting entry that allows an entity to adjust its financial records to reflect more accurately the likelihood that certain funds will eventually be received.

[45] This was possible because Westwoods had elected Subchapter S status under federal tax laws.

[46] *See* 6 *Del.C.* § 3-118; 10 *Del.C.* § 8109.

by a record or by an instrument under seal" are subject to a three-year statute of limitations.[47] The Westwoods loan is not evidenced by a note or other negotiable instrument. Thus, under 10 *Del.C.* § 8106, the question becomes whether it is evidenced by a "record." "Record" could mean official records, such as judgments. The defendants point to the financial statements and tax returns and argue that they constitute "records." If that is true, then it could also be argued that any regularly-maintained business record which evidences a debt would be sufficient to take the debt beyond the scope of § 8106. An interpretation such as that, it can be argued, would not only unduly limit the scope of 10 *Del.C.* § 8106 but, if any piece of paper recording the debt were sufficient, then the specific reference to "instrument under seal" in 10 *Del.C.* § 8106 would also have little purpose. Moreover, with respect to the statutes setting forth the six- and ten-year limitations period, 6 *Del.C.* § 3-118 is specifically limited to negotiable instruments, and 10 *Del.C.* § 8109 addresses promissory notes. Tax returns and financial statements cannot fairly be characterized as such.

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[47] *See* 10 *Del.C.* § 8106.

From the end of 1992 until the Merger (and thereafter), no payment of principal or interest was made on the loan. In 1996, Louis and Joseph decided to write it off as a bad debt. The partnership still owed the debt to Westwoods even though it no longer appeared as a collectible for Westwoods or as an obligation of the partnership. On the other hand, if this is to be treated as a debt collection matter, then the governing statute of limitations might provide a viable affirmative defense.

Original Augustine's treatment of the Westwoods loan, after it was written off, either as a continuing debt or as a relinquished debt, however, was not the proper approach. The debt most likely was "collectible" in full, and certainly it was "collectible" over time in large part. Westwoods simply made no effort to collect it.[48] Because Louis and Joseph owned Westwoods and controlled Original Augustine, the debt, when they decided not to pursue collection should have been treated as a contribution of capital to the partnership, instead of as a bad debt, and

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[48] Q. [the Trustee]: The fact of the matter is that in '96, for example, it would have been easily collectible.
A. [Joseph]: Well, it doesn't make a lot of sense to me. I mean paying myself to pay myself? Tr. 869.

posted to their individual capital accounts.[49] If the Westwoods loan is treated as a contribution of the partners' capital, it should be considered first in determining the value of any other interests in the partnership.

The Court, thus, is confronted with two options. The first would treat the Westwoods debt write-off as a contribution to the partnership for the benefit of the individual capital accounts of Louis and Joseph. The second would hold Louis and Joseph to their decision: they treated it as a debt and never, even though they controlled the partnership, made any attempt to treat the Westwoods debt as an ongoing obligation until after the Merger.[50] By then, collection might have been time-barred. Under this approach, the Trustee would receive, in effect, a windfall because the Westwoods loan benefited the partnership; was not repaid; and, if the

[49] Tr. 432. The Trustee argues that Louis and Joseph have received income tax benefits from the write-offs and that the Court should consider them in determining the appropriate allocation of value within the partnership. Whether Louis and Joseph received tax benefits which they should not have received is a matter better left to the taxing authorities.

[50] The Defendants point out that the Partnership Agreement, at Section 7.2, provides that in liquidation, the general partner "shall . . . provid[e] for the satisfaction of the remaining debt of the Partnership (including any loans made pursuant to Subsection 11.1 [by partners])." Moreover, partners, as fiduciaries, are, in general, allowed to pay to themselves debts that are lawfully owed to them by the partnership. Neither of these principles changes the outcome of the analysis; neither can be read to authorize the satisfaction (in the context of assessing fair value of the partnership) of debts which otherwise could not be collected, in this instance a debt the collection of which may be barred by the applicable statute of limitations.

proper steps had been taken, it would have remained a charge against the amount now owed to the Trustee.[51]

Louis and Joseph were in control of Westwoods and of the partnership. They made the decision to "write off" the Westwoods debt, to take personal advantage of that write-off in their individual tax filings, and not to treat the transaction as a contribution of capital to the partnership. Their choices were, of course, mutually exclusive. It is inconsistent to take the same obligation and "write it off" for tax purposes and then subsequently claim that it was a contribution to the partnership.[52]

Although equity, perhaps, should not avail itself to relieve individuals in control of a partnership from the consequences of the self-interested exercise of their powers, the overriding consideration here is to determine a fair value of the trusts' interests in Original Augustine. Any calculation of fair value of Original

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[51] If the loan had been properly documented—evidenced by a note—a longer statute of limitations would have been applicable. Also, other strategies to avoid any dispute about the continuing enforceability of the debt were available, but were not implemented.

[52] If the Westwoods loan became uncollectible, whether because of an applicable statute of limitations or otherwise, the debt owed to Louis and Joseph converted, for partnership purposes under these circumstances, into a capital contribution. The Westwoods loan has been treated as one by Louis and Joseph. That is consistent both with the parties' perceptions and with the simple fact that Westwoods, for these purposes, was tantamount to an alter ego of Louis and Joseph.

Augustine should reflect the contributions made by Louis and Joseph as a result of the Westwoods loan. Fair value, as a general matter, should be determined in a manner consistent with regular accounting expectations. In this instance, a related party loan which is written off should be treated as a capital contribution.[53] And so it will be here.

That conclusion, however, leaves open the question of interest on Thomas's corresponding shortfall in his capital account. Apparently, no capital call was issued (perhaps because Thomas could not pay in any event). Louis and Joseph, from the time the loan was written off until the Merger, did not view these funds as constituting a capital contribution in Original Augustine. They had dealt with them—but as a bad debt. Thus, during this period, they were not risking their funds (or did not see themselves as risking their funds in an accounting sense) and, in this context, the concerns identified in *Cole v. Kershaw* are not implicated. Accordingly, as a matter of equity, no interest will be charged on Thomas's capital account shortfall resulting from the after-the-merger reconstruction of the proper

[53] By Section 5.3(a) and Section 11.1 of the Partnership Agreement, loans by the limited partners to Original Augustine were not to be considered capital contributions. Provisions, such as these, assure partners that they may lend money to a partnership and retain the rights of creditors. Provisions, such as these, do not preclude the conversion of loans, when the decision is made not to collect them, into capital contributions.

treatment which should have been given (but which Louis and Joseph consciously chose not to give) to the Westwoods loan when it was decided that it would not be collected.

Thus, the capital shortfall, allocable to Thomas (and those claiming through him), based on the treatment of the Westwoods loan as a capital contribution by Louis and Joseph, but without interest, is 22.5% of $1,626,125, or $365,878.[54] The share allocable to the Trustee is $196,761.

IV.

Ascertaining the fair value of Original Augustine also requires other data. Original Augustine had cash and cash equivalents of $1,600,990; prepaid expenses of $55,591; accounts payable of $407,856; and accrued expenses of $111,442. The principal balance of the mortgage on the Property was $15,889,312.[55]

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[54] The effective capital contribution of Louis and Joseph was $1,260,247, the balance of principal and interest on the Westwoods loan as of December 31, 1996. Proportional capital contributions by them in that amount would require a total capital contribution from all partners of $1,626,125. Thomas's share of that, at 22.5%, was $365,878.

[55] DX 14(m) at 4; PX 64; PX 7. These numbers are as of December 31, 2000. They appear to be the most accurate numbers that are available and reasonably close to the date of the Merger. If the parties can direct the Court to numbers that are accurate, consistent, and proximate to the Merger, the Court will consider that data.

V.

The following table summarizes the fair value analysis:

Fair value of the Property:		$ 23,711,232
Cash and Cash Equivalents:		1,600,990
Prepaid Expenses:		55,591
		$ 25,367,813
Accounts Payable	($ 407,856)	
Accrued Expenses	(111,442)	
Mortgage	(15,889,312)	
		($ 16,408,610)
Fair Value of Original Augustine:		$ 8,959,203
Share of the Trustee:		1,084,063
Adjustments:		
1997 Capital Call	($ 300,637)	
Westwoods	(196,761)	
		(497,398)
Fair Value of the Trustee's interest:		$ 586,665

Accordingly, the Trustee is entitled to judgment in his favor in the amount of $586,665, to be reduced by the two payments of $33,333 each made to him by the defendants following the commencement of this litigation, together with the costs of this action and interest on the outstanding balance of this obligation from

March 21, 2001 through the date of payment.[56] A form of order should be prepared and submitted within ten days to implement this letter opinion.

Very truly yours,

/s/ John W. Noble

JWN/cap
cc: Register in Chancery-NC

[56] The Trustee has requested an award of attorneys' fees. That request is denied. Although the defendants contend that a lawyer appearing *pro se* is not entitled to an award of attorneys' fees, the more important principle is the American Rule, *see, e.g., Arbitrium (Cayman Is.) Handels AG v. Johnston*, 705 A.2d 225, 231-32 (Del. Ch. 1997), *aff'd*, 720 A.2d 542 (Del. 1998), which teaches that each party must bear its own legal fees in the absence of grounds for shifting the burden. Among the reasons for fee shifting are statutory authorization, creation of a common fund, and bad faith, either in bringing or during the litigation. The defendants' conduct neither amounts to bad faith nor meets any other criterion that would sustain an award of fees to the Trustee.