**IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE**

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| IN RE JOHN Q. HAMMONS HOTELS INC. SHAREHOLDER LITIGATION | ) ) | Civil Action No. 758-CC |

**MEMORANDUM OPINION**

Date Submitted: July 2, 2009
Date Decided: October 2, 2009

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CHANDLER, Chancellor

This case arises out of the merger in September of 2005 of John Q. Hammons Hotels, Inc. ("JQH" or the "Company") with and into an acquisition vehicle indirectly owned by Jonathan Eilian, pursuant to which the holders of JQH Class A common stock received $24 per share in cash (the "Merger"). Plaintiffs in this purported class action seek damages for the allegedly inadequate price paid for the publicly held Class A shares. Plaintiffs contend that John Q. Hammons, JQH's controlling stockholder, used his control position to negotiate an array of private benefits for himself that were not shared with the minority stockholders. Eilian, a third party with no prior relationship with Hammons or JQH, negotiated with Hammons and the special committee, which was formed to represent and negotiate on behalf of the minority stockholders. The result of these negotiations was that the Class A stockholders received cash for their shares, and Hammons, in exchange for his Class B stock and interest in a limited partnership controlled by JQH, received a small equity interest in the surviving limited partnership, a preferred interest with a large liquidation preference, and various other contractual rights and obligations.

Plaintiffs contend that Hammons breached his fiduciary duties as a controlling stockholder by negotiating benefits for himself that were not shared with the minority stockholders. Plaintiffs also contend that the JQH directors breached their fiduciary duties by allowing the Merger to be negotiated through an

allegedly deficient process, and by voting to approve the Merger. Plaintiffs also assert claims against the Merger acquisition vehicles for aiding and abetting the breaches of fiduciary duty. Finally, plaintiffs assert four disclosure claims based on alleged misstatements and omissions in the Company's proxy statement.

Before the Court are cross-motions for summary judgment, and the threshold issue is whether the Court should apply the entire fairness or business judgment standard of review. Defendants argue that business judgment is the appropriate standard of review because (1) Hammons was not involved in the process of negotiation for the purchase of the minority shares, (2) the minority stockholders were adequately represented by the disinterested and independent special committee, and (3) a majority of the minority stockholders approved the Merger in a fully informed vote. Plaintiffs, of course, disagree, and contend that entire fairness is the appropriate standard of review because (1) the special committee was ineffective, (2) the majority of the minority vote was "illusory," and (3) Hammons was subject to a conflict of interest because he negotiated benefits for himself that were not shared with the minority stockholders. Plaintiffs assert that the minority stockholders were "coerced" into accepting the Merger because the price of the Class A stock did not reflect the Company's true value. Moreover, according to plaintiffs, Hammons's ability to block any transaction limited the

special committee's ability to negotiate at arm's length and relegated it to the subservient role of negotiating only with bidders acceptable to Hammons.

As explained below, I conclude that *Kahn v. Lynch Communication Systems, Inc.*[1] does not mandate application of the entire fairness standard of review in this case, notwithstanding any procedural protections that may have been used. Rather, the use of sufficient procedural protections for the minority stockholders *could* have resulted in application of the business judgment standard of review in this case. The procedures used here, however, were not sufficient to invoke business judgment review. Accordingly, the appropriate standard of review is entire fairness. As explained below, defendants' motions for summary judgment are granted in part and denied in part, and plaintiffs' motion for summary judgment is granted in part and denied in part.

## I. BACKGROUND

### *A. The Parties*

Defendant JQH was a Delaware corporation headquartered in Springfield, Missouri that engaged in the business of owning and managing hotels. JQH owned forty-four hotels and managed another fifteen. Most of the hotels were franchised under major trade names, such as Embassy Suites Hotels, Holiday Inn, and

[1] 638 A.2d 1110 (Del. 1994).

Marriott, and located in or near a stable "demand generator" such as a state capital, university, convention center, corporate headquarters, or office park.

JQH was formed in 1994, and used the proceeds from its initial public stock offering to purchase an approximately 28% general partnership interest in John Q. Hammons Hotels, LP ("JQHLP"). Hammons owned the remaining 72% of JQHLP as its sole limited partner. JQH conducted its business operations through JQHLP.

Ownership of JQH was held through two classes of stock. The Class A common stock was publicly traded and entitled to one vote per share. The Class B common stock was not publicly traded and was entitled to fifty votes per share. Hammons and his affiliates owned approximately 5% of the Class A common stock and all of the Class B common stock. Thus, Hammons had approximately 76% of the total vote in JQH, which in turn controlled JQHLP as its sole general partner. Plaintiffs Jolly Roger Fund, LP, Jolly Roger Offshore Fund, Ltd., and Lemon Bay Partners were purported owners of Class A common stock.

The JQH Board of Directors (the "Board") was composed of eight members at the time of the Merger. Hammons was Chairman of the Board and Chief Executive Officer. The other Board members were John E. Lopez-Ona, Daniel L. Earley, William J. Hart, David C. Sullivan, Donald H. Dempsey, James F. Moore, and Jacqueline A. Dowdy.

Defendants JQH Acquisition, LLC ("Acquisition") and JQH Merger Corporation ("Merger Sub") were formed to facilitate the Merger. Eilian is the principal of Acquisition. Merger Sub is a wholly owned subsidiary of Acquisition.

*B. The Company and Hammons Before the Merger*

The price of JQH Class A shares declined after the initial public offering at $16.50 per share, and, according to plaintiffs, eventually traded in the $4 to $7 range until sometime in 2004, when rumors of a possible merger first circulated. Plaintiffs suggest that low stock price could have resulted from the small number of publicly traded shares, the lack of an active trading market in those shares, the lack of any meaningful analyst coverage, and the lack of large institutional investors. Plaintiffs also contend that the shares were "burdened" by the presence of a large controlling stockholder, and that Hammons's self-dealing depressed the price of the Class A shares.

Hammons's passion was, and is, developing hotels, and Hammons took pride in the quality of his hotels. Hammons was seen by many as a legend in the hotel business, as evidenced by his biography, *They Call Him John Q.: A Hotel Legend*.[2] It also appears, however, that the relationship between Hammons and the Board was, at least at times, tense.

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[2] Susan M. Drake, *They Call Him John Q.: A Hotel Legend* (2002).

Plaintiffs cite evidence and quote from Hammons's biography for the proposition that Hammons only reluctantly sold shares in JQH to the public, that he disliked the procedural requirements associated with public stockholders and a board of directors, and that there was tension between Hammons and the Board. Indeed, Hammons and the Board had disagreements over the Board's use of stock options as compensation and over the pace of hotel development. The latter disagreement resulted in the Board's call for a moratorium on the development of hotels by the Company. This moratorium led the Board and Hammons to negotiate an arrangement where Hammons was permitted to use Company resources for his private development activities, in exchange for giving the Company the opportunity to manage such hotels and acquire them if they were offered for sale.

Hammons and the Board also disagreed over Hammons's decision to offer Lou Weckstein, who Hammons hired as JQH's President in 2001 without consulting the Board, a salary that the Board believed was excessive. This conflict led to deterioration of the relationship between Hammons and Hart, who was then Hammons's personal attorney, and led the Board to retain Katten Muchin Rosenman, LLP ("Katten Muchin") to advise the non-employee members of the Board on how to react to Hammons's hiring of Weckstein.

Plaintiffs point to Eilian's description in a March 7, 2005 email sent during the negotiations that Hammons practiced a "'liberal' mixing of private and

personal expenses and competitive interests." In its 2004 10-K the Company disclosed that:

> Mr. Hammons also (1) owns hotels that we manage; (2) owns an interest in a hotel management company that provides accounting and other administrative services for all of our hotels; (3) owns a 50% interest in the entity from which we lease our corporate headquarters; (4) has an agreement whereby we pay up to 1.5% of his internal development costs for new hotels in exchange for the opportunity to manage the hotels and the right of first refusal to purchase the hotels in the event they are offered for sale; (5) leases space to us in two trade centers owned by him that connect with two of our hotels; (6) has the right to require the redemption of his LP Units; (7) utilizes our administration and other services for his outside business interests, for which he reimburses us; (8) utilizes the services of certain of our employees in his personal enterprises and personally subsidizes those employees' compensation; and (9) owns the real estate underlying one of our hotels, which we lease from him.[3]

Plaintiffs also point to a conflict surrounding rent the Company paid to Hammons for meeting space adjacent to one of the Company's hotels in Portland, Oregon. Plaintiffs cite evidence that, according to Weckstein and Paul Muellner, JQH's chief financial officer, Hammons insisted on a rent well in excess of market rates and opposed the lower rental offer they proposed.

Around early 2004, Hammons and the Board also had conflicts over the plan to dispose of certain Holiday Inn hotels that the Board and management (other than Hammons) deemed were no longer "core assets" of the Company. Hammons, who Muellner described as having an "emotional attachment" to the Holiday Inn

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[3] JQH's 2004 Form 10-K at 4.

brand, opposed the sale of some of the hotels and even threatened to take legal action to stop the Board from selling one of the properties. On a separate occasion, without disclosure to the Board, Hammons entered into a private agreement with a listing broker that gave Hammons a right of first refusal, which would have allowed Hammons to match an offer in the event a third-party offer was approved by the Board. The arrangement was later discovered and disclosed to the Board by the Company's general counsel.

*C. The Barceló Offer and the Creation of the Special Committee*

In early 2004, Hammons informed the Board that he had begun discussions with third parties regarding a potential sale of JQH or his interest in JQH. On October 15, 2004, one of these third parties, Barceló Crestline Corporation ("Barceló"), informed the Board that it had entered into an agreement with Hammons and that it was offering $13 per share for all outstanding shares of JQH Class A common stock.

The agreement Barceló reached with Hammons reflected Hammons's tax and other personal objectives. Hammons's tax situation made it essential to him that any transaction be structured to avoid the large tax liability that would result from a transaction that was deemed to be a disposition event for Hammons. To accomplish this goal, Hammons had to retain some ownership in the surviving limited partnership and continue to have capital at risk. Hammons also desired,

among other things, a line of credit that would allow him to continue to develop hotels. Thus, the deal announced by Barceló was structured such that in exchange for his interests in JQH and JQHLP, Hammons would receive a small ownership percentage in Barceló's acquisition vehicle and a preferred interest with a large liquidation preference. The Barceló transaction also provided that Hammons would receive a line of credit of up to $250 million and distribution of Chateau on the Lake Resort (the "Chateau Lake property"), one of JQH's premier properties.

Recognizing that Hammons's interests in the transaction may not have been identical to those of the unaffiliated JQH stockholders, the Board formed a special committee to evaluate and negotiate a proposed transaction on behalf of the unaffiliated stockholders and make a recommendation to the Board. The special committee consisted of Sullivan, Dempsey, and Moore.[4] Discussions at the initial meetings of the special committee in October 2004 reveal that the members realized that the special committee lacked the ability to broadly market the Company in light of Hammons's controlling interest and ability to reject any transaction. Thus, the special committee determined that its goal was to pursue the best price reasonably available to minority stockholders in any transaction the special committee was authorized to consider. The special committee also

[4] Hart and Lopez-Ona were also initially on the special committee, but withdrew in light of questions that may have been raised regarding their relationship with the Company and Hammons. At the special committee's request, Hart continued to attend special committee meetings as an advisor.

recognized its duty to recommend against a transaction if the committee concluded that the transaction was not in the best interests of the minority stockholders or if the price offered to the minority stockholders was not fair, from a financial perspective, to the minority stockholders. On the advice of its counsel, the special committee also adopted guidelines that provided that the special committee would conduct a process in which (1) stockholders would be provided a reasonable opportunity to express their views to the committee, (2) all parties interested and willing to explore a transaction would be afforded a level playing field, from the Company's perspective, on which to pursue a transaction in terms of timing and access to information, and (3) the committee and its advisors would be fully informed as to the value, merits, and probability of closing any transaction that there was a reasonable basis for believing could be consummated. The special committee retained Katten Muchin as its legal advisor and Lehman Brothers ("Lehman") as its financial advisor.

The special committee also discussed that, after Barceló's public announcement, Eilian had contacted members of the special committee and told them he was interested in entering into a possible transaction with the Company. Eilian indicated that Hammons had suggested that he contact the special committee if he felt he could offer a proposal superior to Barceló's. The special committee

agreed that its counsel would contact Eilian and inform him that Lehman had been retained as the special committee's financial advisor.

Although Barceló's agreement with Hammons expired by its terms on November 1, 2004, both Barceló and Hammons remained interested in going forward with the transaction pursuant to a new agreement. On November 16, 2004, the Board (with Hammons abstaining) expanded the authority of the special committee to review, evaluate, and negotiate on behalf of the unaffiliated stockholders the terms of the revised Barceló proposal. The Board also gave the special committee the authority to respond to, and act on behalf of the board with respect to, any requests from interested parties.

On December 5, 2004, following a November 18, 2004 meeting with the special committee, Eilian submitted a proposal to the special committee whereby his group would acquire the interests of Hammons in the Company and make a tender offer for the unaffiliated stockholders at a price to be determined.[5] In November, the special committee met with various shareholder groups, including representatives of plaintiffs.

[5] Although the special committee had indicated that it would seek to provide "a level playing field" in terms of access to information, the special committee determined at a November 30, 2004 meeting that it would not place JQH management in a "tenuous position" by overriding Hammons's instruction to JQH's general counsel not to send due diligence materials to Eilian at that time. Hammons had expressed that he would not do a deal with Eilian under any circumstances. Nevertheless, the special committee attempted to encourage Eilian and his advisors to not let Hammons's instruction dissuade them from continuing to evaluate a possible transaction and maintaining an open dialogue with the Company's financial advisor.

On December 6, 2004, the special committee reviewed the outstanding proposals of Barceló and Eilian. After receiving a preliminary evaluation from Lehman that Barceló's $13 per share offer was inadequate, from a financial point of view, to the minority stockholders, the special committee unanimously agreed to recommend to the Board that it reject Barceló's revised agreement with Hammons. The next day, the special committee advised the Board that Barceló's offer was not acceptable, and the Company issued a press release stating that the Company would not accept the Barceló proposal.

At a December 23, 2004 meeting, two special committee members reported that A.G. Edwards had contacted them on behalf of Eagle Hospitality Properties Trust, Inc. ("Eagle"). The committee, after observing that Eagle would need to raise significant capital, that a transaction with Eagle would involve a significant amount of strategic and financial risks, and that there was no basis to believe that Hammons would have any interest in pursuing a transaction with Eagle, concluded that the inquiry from Eagle was not worth pursuing at that point in time.

By December 28, 2004, Barceló was willing to pay $21 per share of Class A common stock if the transaction was subject to approval by a simple majority of shares, including those owned by Hammons. Barceló was willing to pay only $20 per share if a separate majority of the minority vote was required. Eilian's proposed transaction with a tender offer for the Class A shares of at least $20.50

per share had been outlined to the special committee on December 23, 2004. At the December 28 meeting, the special committee discussed both proposals and concluded that the Barceló proposal was more fully negotiated and stood a far greater chance of being consummated.

At a December 29, 2004 meeting, the special committee was informed that Barceló was willing to increase its offer to acquire the Class A stock to $21 per share and agree that any merger be conditioned on a majority vote of the unaffiliated stockholders. Lehman advised the special committee that the $21 per share offer was fair to the minority stockholders from a financial point of view and that the allocation of consideration between the minority stockholders and Hammons was reasonable.

At a Board meeting later that day, the special committee advised the Board of Barceló's revised proposal as well as the proposal from Eilian's group that would offer $20.50 per share for all Class A shares. Hammons indicated that he was no longer interested in a transaction with Eilian. Based on the special committee's recommendation, the Board resolved to provide Barceló with exclusivity until January 31, 2005.

Negotiations proceeded between Barceló and Hammons, but Hammons was ultimately not comfortable with the proposal, particularly because he believed that the three-year commitment on the line of credit was not sufficient. An agreement

was not reached by January 31, and Hammons indicated that he was unwilling to extend exclusivity with Barceló. The special committee then recommended to the Board that the Company not renew exclusivity with Barceló, and the Board followed this recommendation.

*D. The Eilian Offer*

On January 31, 2005, the special committee received an offer from Eilian's group by which Acquisition would acquire all outstanding Class A common stock for $24 per share. Eilian's letter to the special committee indicated that the offer was not contingent on third-party financing and that certain Class A stockholders unaffiliated with Hammons had entered into agreements pursuant to which those stockholders agreed to support Eilian's proposal.[6] The committee informed the Board of this offer, and the Board voted to continue the existence and authorization of the special committee.

At a February 3, 2005 Board meeting, Hammons informed the Board that he would like to negotiate a transaction with Eilian. At the same meeting, the Board was informed that the Company had received an expression of interest from Eagle and from Corporex Companies. The Board concluded that because Eagle and Corporex did not come forward sooner after the expiration of the exclusivity period with Barceló and because of many other factors discussed at the meeting,

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[6] According to defendants, these unaffiliated stockholders represented approximately 23% of the public Class A common stockholders.

the Board would not pursue a transaction with that group and would instead proceed expeditiously to negotiate a transaction with Eilian. Based upon a recommendation from the special committee, the Board granted Eilian exclusivity until February 28, 2005.

Over the next several months, representatives of Eilian, Hammons, and the special committee continued to negotiate the terms of a potential deal, during which time the exclusivity agreement with Elian was renewed several times. On June 3, 2005, Hammons and Acquisition (Eilian's acquisition vehicle) informed the special committee that they had reached certain agreements and requested the special committee's approval of them. Acquisition also reaffirmed its offer to purchase all the outstanding shares of Class A common stock held by unaffiliated stockholders for $24 per share.

On June 14, 2005, the special committee met with its advisors. Katten Muchin reviewed the process the special committee used over the previous nine months and provided an overview of the various agreements between Hammons and Acquisition. Lehman provided a presentation of its analysis and methodology in issuing its fairness opinion that the $24 per share price was fair to the minority stockholders from a financial point of view. Lehman also advised the special committee of its opinion that the allocation of the consideration between Hammons and the unaffiliated stockholders was reasonable. Lehman calculated that the

value received by Hammons and his affiliates was between $11.95 and $14.74 per share. The special committee then approved the merger agreement (the "Merger Agreement") and the related agreements between Hammons and Eilian (collectively with the Merger Agreement, the "Transaction Agreements").

The Board met immediately following the June 14 special committee meeting. Hammons advised the Board that he supported the proposed transactions and then recused himself from the meeting. After presentations from Katten Muchin on the Transaction Agreements and the Board's fiduciary duties, and from Lehman on its fairness opinion, the Board voted to approve the Merger and the Transaction Agreements.

*E. The Merger and the Transaction Agreements*

The Merger Agreement provided that each share of Class A common stock would be converted into the right to receive $24 per share in cash upon consummation of the Merger. The Merger was contingent on approval by a majority of the unaffiliated Class A stockholders, unless that requirement was waived by the special committee.[7] The Merger Agreement included a termination fee of up to $20 million and a "no shop" provision that placed limitations on the Company's ability to solicit offers from other parties. Moreover, Hammons agreed

[7] As explained below, plaintiffs discount the majority of the minority vote because it only required approval of a majority of the minority shares voting, as opposed to a majority of all the minority shares.

to vote his interests in favor of the Merger and against any competing proposal or other action that would prevent or hinder the completion of the Merger.

In addition to the Merger Agreement, Hammons and Acquisition entered into a series of other agreements, which provided for a complex, multi-step transaction designed to provide Hammons financing to continue his hotel development activities without triggering the tax liability associated with an equity or asset sale. Although each Class B share initially remained a share of common stock of the surviving corporation, those shares were eventually converted into a preferred interest in the surviving limited partnership (the "surviving LP"). In order to achieve his tax goals, Hammons had to have an ownership interest in the surviving LP and continue to have capital at risk. Accordingly, Hammons was allocated a 2% interest in the cash flow distributions and preferred equity of the surviving LP. Atrium GP, LLC, an Eilian company, became general partner of the surviving LP and received a 98% ownership interest. Hammons's preexisting limited partner interest in JQHLP was converted into a capital account associated with his preferred interest in the surviving LP, which had a liquidation preference of $328 million. When combined with the preferred interest from the conversion of his Class B shares, Hammons's capital account totaled a liquidation preference of $335 million. The partnership agreement provided for events in which the capital account could be distributed during Hammons's lifetime, but because of

certain tax consequences, it was anticipated that distribution of the capital account was to occur at Hammons's death.

The terms of the Transaction Agreements also provided Hammons other rights and obligations.[8] Importantly, Hammons received a $25 million short-term line of credit and a $275 million long-term line of credit. Hammons also received (1) the Company's Chateau Lake property in exchange for transferring certain assets and related liabilities to an Acquisition affiliate, (2) a right of first refusal to acquire hotels sold post-merger, and (3) an indemnification agreement for any tax liability from the surviving LP's sale of any of its hotels during Hammons's lifetime. Hammons and Eilian entered into a reciprocal agreement that imposed restrictions on the development of new hotels that would compete with existing hotels owned by either party. Hammons also obtained an agreement whereby his management entity would continue to manage the hotels in exchange for payments of actual operating costs and expenses incurred (estimated to be approximately $6.5 million based on the budget for 2005) and a $200,000 annual salary to Hammons, plus benefits.[9]

On August 24, 2005, the Company sent a proxy statement to its stockholders in connection with the vote on the Merger at a special meeting of stockholders on

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[8] There were numerous agreements required to execute the complex series of transactions associated with the Merger, some of which are not described in this opinion.

[9] Hammons apparently had high standards for his hotels, and took pride in his organization's reputation for quality products. The management agreement allowed Hammons to ensure the hotels were maintained to his standards.

September 15, 2005. Of the 5,253,262 issued and outstanding shares of Class A stock, 3,821,005 shares, or over 72%, were voted to approve the Merger. In total, more than 89% of the Class A shares that voted on the Merger voted to approve it. The Merger closed on September 16, 2005.

*F. Plaintiffs' Contentions Regarding the Negotiation Process*

Plaintiffs paint a picture of the negotiation process that is dominated by Hammons's ability to walk away and block any transaction, which would have left plaintiffs holding illiquid stock that would likely trade in the $4 to $7 range.[10] According to plaintiffs, this threat relegated the special committee to a passive, tag-along role and forced them to be "friends of the deal" in an effort to prevent Hammons from backing out of the deal.

Plaintiffs also contend that both Katten Muchin and Lehman developed conflicts of interest that biased them in favor of completing a transaction with Eilian. In March 2005, Katten Muchin informed the special committee that it would be representing the entity providing Eilian's financing, iStar Financial Inc. ("iStar"), in connection with the Merger. Plaintiffs contend that this representation gave Katten Muchin an incentive to ensure the Merger proceeded with Eilian, and that iStar played a substantial role in negotiation of the transactions between

[10] To support this assertion, plaintiffs point to statements of special committee members and others that suggest that there were numerous complex issues on Hammons's side of the deal and that, from the perspective of a potential bidder, Hammons was difficult to deal with and had a history of walking away from proposed transactions after significant negotiations.

Hammons and Eilian. Defendants point out that a separate team of lawyers represented iStar and was prohibited from discussing the transaction with the team representing the special committee. The special committee discussed the matter and waived the conflict. The conflict, however, was not disclosed in the proxy statement.

Plaintiffs also assert that Lehman faced a conflict of interest because it sought a role in Eilian's planned refinancing of the Company's debt. Although Lehman did not get the business, plaintiffs contend that Lehman had multiple contacts with Eilian and that "Lehman's efforts to secure business that would have dwarfed the value of its advisory services to the Special Committee" presented a "clear conflict" that was not disclosed in the Company's proxy statement.[11] Defendants contend that the group at Lehman that contacted Eilian about the debt refinancing was separate from the group advising the special committee. Defendants further contend that the alleged conflict was not material and that there is no evidence that Lehman's opinion was affected because the contacts regarding the debt refinancing occurred after Lehman had opined to the special committee in December 2004 that a bid of $21 per share was fair to the minority stockholders.

[11] Pls.' Br. in Supp. of their Cross-Mot. for Partial Summ. J. & in Opp'n to Defs.' Mots. for Summ. J. (Pls.' Opening Br.") 34.

*G. The Litigation*

This action was filed on October 20, 2004. The now-operative Second Amended and Consolidated Supplemental Class Action Complaint was filed on October 3, 2006. On October 24, 2008, after discovery and an unsuccessful attempt at mediation, the defendants other than Hammons filed their motion for summary judgment.[12] The director defendants seek summary judgment on the grounds that (1) plaintiffs cannot satisfy their burden to rebut the presumption of the business judgment rule, (2) the special committee members and the director defendants are shielded from monetary liability pursuant to the Company's 8 *Del. C.* § 102(b)(7) exculpatory provision, and (3) there is no evidence to support the aiding and abetting claim. On February 20, 2009, after additional discovery, Hammons filed his motion for summary judgment. Hammons contends that he took no part in the negotiations for the purchase of the minority's shares and argues that he is entitled to summary judgment because plaintiffs cannot rebut the presumption of the business judgment rule and because even if entire fairness applies, Hammons acted fairly. On April 17, 2009, plaintiffs filed their motion for partial summary judgment. Plaintiffs seek summary judgment holding that (1) entire fairness is the applicable standard of review, (2) the special committee

[12] The JQH directors other than Hammons are referred to collectively as the "director defendants." JQH, Acquisition, and Merger Sub were also part of the director defendants' motion for summary judgment.

process and stockholder vote were ineffective and the burden of persuasion at trial remains with defendants, (3) the challenged transactions were the result of unfair dealing, (4) certain defendants are liable for aiding and abetting Hammons's breach, and (5) the only issue for trial is therefore fair price. Plaintiffs now concede that *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[13] does not govern the duties of the Board, that the special committee was disinterested and independent (although not free from coercion by Hammons), and that a number of the disclosure violations previously alleged should be withdrawn.

## II. ANALYSIS

### *A. The Summary Judgment Standard*

Summary judgment is appropriate if the moving party demonstrates that there is "no genuine issue as to any material fact" and that it is "entitled to a judgment as a matter of law."[14] The court views the evidence in the light most favorable to the nonmoving party[15] and assumes the truth of uncontroverted facts set forth in the record.[16] When the moving party shows that no genuine issue of material fact exists, "the burden shifts to the nonmoving party to substantiate its adverse claim by showing that there are material issues of fact in dispute."[17] If the

[13] 506 A.2d 173 (Del. 1986).
[14] Ct. Ch. R. 56(c); *see Gilbert v. El Paso Co.*, 575 A.2d 1131, 1142 (Del. 1990); *Conway v. Astoria Fin. Corp.*, 837 A.2d 30, 36 (Del. Ch. 2003), *aff'd*, 840 A.2d 641 (Del. 2004) (TABLE).
[15] *Conway*, 837 A.2d at 36.
[16] *Tanzer v. Int'l Gen. Indus., Inc.*, 402 A.2d 382, 386 (Del. Ch. 1979).
[17] *Conway*, 837 A.2d at 36 (quotation omitted).

nonmoving party bears the burden of proof, summary judgment is appropriate where that party fails to make a sufficient showing on any essential element of its case.[18]

*B. The Standard of Review: Entire Fairness or Business Judgment?*

The threshold issue is whether the Court should apply the entire fairness standard or the business judgment standard in reviewing the Merger. Plaintiffs label the Merger a "minority squeeze-out transaction" and contend that *Kahn v. Lynch Communication Systems, Inc.*[19] mandates that the Court apply the entire fairness standard of review, while defendants urge the Court to apply the business judgment standard of review.

In *Lynch* the Delaware Supreme Court held "that the exclusive standard of judicial review in examining the propriety of an interested cash-out merger transaction by a controlling or dominating shareholder is entire fairness" and that "[t]he initial burden of establishing entire fairness rests upon the party who stands on both sides of the transaction."[20] Additionally, "approval of the transaction by an independent committee of directors or an informed majority of minority

[18] *Burkhart v. Davies*, 602 A.2d 56, 59 (Del. 1991).
[19] 638 A.2d 1110 (Del. 1994).
[20] *Id.* at 1117 (citations omitted).

shareholders" would shift the burden of proof on the issue of fairness to the plaintiff, but would not change that entire fairness was the standard of review.[21]

Plaintiffs contend that *Lynch* controls this case and mandates application of the entire fairness standard, regardless of any procedural protections that were used that may have protected the minority stockholders. Plaintiffs argue that Hammons stood on both sides of the transaction because he did not in fact sell his interest in the companies to Eilian, but rather restructured them in a way that accomplished his tax and financing goals while maintaining a significant interest in the surviving company, in addition to other rights. Plaintiffs point not only to Hammons's numerous contractual arrangements and continuing preferred interest in the surviving LP, but also to statements from various witnesses that the transaction was not actually a "sale" by Hammons but rather a "joint venture of some sort" or a "recapitalization" designed to accomplish Hammons's tax and liquidity needs. Thus, plaintiffs contend:

> as viewed from a legal and tax standpoint, as communicated to employees and the public, and as understood by the transaction participants themselves, the Related Transactions effected a restructuring in which Mr. Hammons brought in a business partner and obtained access to financing while retaining most of his equity (in modified form), together with substantial upside from future growth of JQH, significant veto rights over future operations of the Company,

[21] *Id.* A different standard applies to transactions that effectively cash out minority shareholders through a tender offer followed by a short-form merger. *See In re Aquila Inc.*, 805 A.2d 184, 190-91 (Del. Ch. 2002); *In re Siliconix Inc. S'holders Litig.*, 2001 WL 716787, at *6-9 (Del. Ch. June 21, 2001); s*ee generally In re Pure Res., Inc. S'holders Litig.*, 808 A.2d 421, 434-39 (Del. Ch. 2002).

> and continued direct management of the Company's hotel properties. Under these circumstances, the rule of *Lynch*—that "the exclusive standard of judicial review in examining the propriety of an interested cash-out merger transaction by a controlling or dominating shareholder is entire fairness,"—applies directly.[22]

Although plaintiffs' argument has some appeal, ultimately, I disagree. Unlike in *Lynch*, the controlling stockholder in this case did not make the offer to the minority stockholders; an unrelated third party did. Eilian had no prior relationship with the Company or with Hammons. Eilian negotiated separately with Hammons, who had a right to sell (or refuse to sell) his shares, and with the minority stockholders, through the disinterested and independent special committee. The rights Hammons retained after the Merger—the 2% interest in the surviving LP, the preferred interest with a $335 million liquidation preference, and various other contractual rights and obligations—do not change that *Eilian* made an offer to the minority stockholders, who were represented by the disinterested and independent special committee. Put simply, this case is not one in which Hammons stood "on both sides of the transaction."[23] Accordingly, *Lynch* does not mandate that the entire fairness standard of review apply notwithstanding any procedural protections that were used.[24]

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[22] Pls.' Opening Br. 44 (citation omitted).

[23] *Lynch*, 638 A.2d at 1117.

[24] Importantly, and as explained below, this result does not provide a final answer to the standard of review that will be applied.

Plaintiffs further contend that, even if Hammons did not stand on both sides of the transaction as contemplated in *Lynch*, the policy rationales underlying the *Lynch* decision warrant extending its holding to this case. In support of this position, plaintiffs cite several Court of Chancery decisions in which the Court applied or extended *Lynch*. Although I do not fully address all the cases plaintiffs cite in support of this argument, I generally reach two conclusions with respect to them: first, the cases plaintiffs cite can be factually distinguished from this case, and second, to the extent those cases extended the application of *Lynch* based on certain policy rationales, I decline to do so here.

For example, in *In re Tele-Communications, Inc. Shareholders Litigation*,[25] the evidence suggested that a majority of the board of directors was interested because they received material personal benefits from the transaction they approved.[26] Specifically, the transaction materially benefited a majority of the directors because it allocated a disproportionate amount of the merger consideration to the directors' class of stock.[27] Moreover, only one of those directors was a controlling stockholder entitled to a control premium.[28] Thus, the interestedness of a majority of the directors led the Court to apply the entire fairness standard and to conclude that, as in *Lynch*, the approval of the transaction

[25] 2005 WL 3642727 (Del. Ch. Dec. 21, 2005).
[26] *Id.* at *8.
[27] *Id.* at *7.
[28] *Id.* at *14.

by the stockholders and a special committee could at most shift the burden of demonstrating entire fairness to plaintiffs.[29] Here, in contrast, Hammons negotiated with Eilian and did not participate in the negotiations between Eilian and the special committee. Nothing in *In re Tele-Communications* mandates the extension of *Lynch* to this case.[30]

In *In re LNR Property Corp. Shareholders Litigation*,[31] the complaint alleged that the board breached its fiduciary duties by allowing a conflicted controlling shareholder, who was acting as both buyer and seller in the transaction, to "personally negotiate[] a one-sided deal that allowed him and select members of management to continue to reap the benefits of [the company's] future growth

[29] *Id.* at *8. Because of the conflict of interest of a majority of the board in that case, the Court in *In re Telecommunications* determined that entire fairness review should apply to the transaction. The Court also determined that, as in *Lynch*, approval by shareholders and a special committee could shift the burden of entire fairness to plaintiffs. Nothing in that case, however, suggests that such a rule must apply in every case in which the Court is determining whether to apply entire fairness review. In other words, the result in *Lynch*—that shareholder and special committee approval merely shifts the burden of entire fairness—does not preclude the possibility that shareholder and special committee review could be relevant in determining whether to apply business judgment or entire fairness in a case that is not governed by *Lynch*.

[30] Plaintiffs also cite *In re Cysive, Inc. S'holders Litig.*, 836 A.2d 531 (Del. Ch. 2003) and *In re W. Nat'l Corp. S'holders Litig.*, 2000 WL 710192 (Del. Ch. May 22, 2000). In *Cysive*, however, the Court addressed the question of whether the stockholder, who made the buy-out proposal to the minority stockholders, was a "controlling stockholder" for purposes of *Lynch*, and concluded that the large stockholder "possess[ed] the attributes of control that motivate the *Lynch* doctrine." *Cysive*, 836 A.2d at 551-552. In *W. Nat'l*, the plaintiff challenged the merger between Western National Corporation and its 46% stockholder. The Court concluded that the record did not support a finding of control. *W. Nat'l* at *5-10. Here, in contrast, there is no dispute that Hammons was the controlling stockholder of JQH. Hammons, however, did not make the offer to the minority stockholders or agree to a merger with JQH. Rather, an unaffiliated third-party negotiated separately with Hammons and the special committee.

[31] 896 A.2d 169 (Del. Ch. 2005).

while cutting out plaintiff and the class."[32] The complaint also alleged that the controlling shareholder dominated and controlled the board and the "sham" special committee, which did not have the authority to engage in independent negotiations.[33] Taking the allegations in the complaint in the light most favorable to plaintiffs, the Court could not, on a motion to dismiss, rule out the possibility that the entire fairness standard would apply because the controlling stockholder negotiated the transaction, including the allocation of a 20.4% stake in the resulting company for himself.[34] The Court noted, however, that "[t]here is authority for the proposition that the mere fact that a controller has or may be acquiring some interest in the buyer does not automatically trigger entire fairness review."[35] The Court noted that the business judgment standard of review may ultimately apply if, at a later stage, the defendants are able to show that the interests of the minority stockholders were adequately protected. As the *LNR Property* Court stated:

> Of course, the defendants may be able to show at the summary judgment stage that Miller, as they argue, negotiated this transaction as a seller, not a buyer, and that the board and the Special Committee were entitled to repose confidence in his unconflicted motivation to obtain the maximum price for all LNR stockholders. In that case, the court may well be able to conclude that the measures taken by the

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[32] *Id.* at 176. Similarly, in *Ryan v. Tad's Enterprises, Inc.*, 709 A.2d 682 (Del. Ch. 1996) and *In re Dairy Mart Convenience Stores, Inc.*, 1999 WL 350473 (Del. Ch. May 24, 1999), the Court applied entire fairness review where the controlling stockholder negotiated the transaction on behalf of the company and the minority stockholders.
[33] *Id.* at 176-77.
[34] *Id.* at 178.
[35] *Id.* at 177-78 (citing *Orman v. Cullman*, 794 A.2d 5, 21-22 n.36 (Del. Ch. 2002); *In re Budget Rent A Car Corp. S'holders Litig.*, 1991 WL 36472, at *3 (Del. Ch. Mar. 15, 1991)).

> board and the Special Committee to protect the interests of the minority were adequate in the circumstances to invoke the business judgment standard of review. Nonetheless, those facts and circumstances do not appear in the well pleaded allegations of the complaint.[36]

Although I have determined that the measures taken in this case were not "adequate in the circumstances to invoke the business judgment standard of review," this result is not mandated by *Lynch*. Rather, it results from deficiencies in the specific procedures used in this case. In other words, I accept defendants' argument that *Lynch* does not mandate the application of entire fairness review in this case, notwithstanding any procedural protections for the minority stockholders.[37] In this case—which, again, I have determined is not governed by *Lynch*—business judgment would be the applicable standard of review if the transaction were (1) recommended by a disinterested and independent special committee, *and* (2) approved by stockholders in a non-waivable vote of the majority of all the minority stockholders.[38]

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[36] *Id.* at 178.

[37] Although I have determined that the facts of this case fall outside the ambit of *Lynch*, I am also cognizant of recent suggestions of ways to "harmonize" the standards applied to transactions that differ in form but have the effect of cashing out minority stockholders. *See In re Cox Commc'ns, Inc. S'holders Litig.*, 879 A.2d 604, 606-07, 642-48 (Del. Ch. 2005); *In re Cysive, Inc. S'holders Litig.*, 836 A.2d 531, 549 n.23 (Del. Ch. 2003); *In re Pure Res.*, 808 A.2d at 443-46.

[38] Of course, it is not sufficient for the special committee to merely be disinterested and independent. Rather, the committee must be given sufficient authority and opportunity to bargain on behalf of the minority stockholders, including the ability to hire independent legal and financial advisors. Moreover, neither special committee approval nor a stockholder vote would be effective if the controlling stockholder engaged in threats, coercion, or fraud. As explained below, plaintiffs contend that the price of the minority shares was depressed as a result of Hammons's improper self-dealing conduct and that as a result the special committee and the

I reject, however, defendants' argument that the procedures used in this case warrant application of the business judgment standard of review. Although I have determined that Hammons did not stand "on both sides" of this transaction, it is nonetheless true that Hammons and the minority stockholders were in a sense "competing" for portions of the consideration Eilian was willing to pay to acquire JQH and that Hammons, as a result of his controlling position, could effectively veto any transaction. In such a case it is paramount—indeed, necessary in order to invoke business judgment review—that there be robust procedural protections in place to ensure that the minority stockholders have sufficient bargaining power and the ability to make an informed choice of whether to accept the third-party's offer for their shares.

Here, the vote of the minority stockholders was not sufficient both because the vote could have been waived by the special committee and because the vote only required approval of a majority of the minority stockholders voting on the matter, rather than a majority of all the minority stockholders. Defendants would no doubt argue that the special committee merely had the ability to waive the vote but chose not to waive it in this case and that the Merger was in fact approved by a majority of all the minority stockholders. Importantly, however, the majority of

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minority stockholders were coerced into accepting the Merger. If a plaintiff were able to make such a showing, even special committee approval and a majority of the minority vote would not invoke the business judgment standard of review. Similarly, a stockholder vote would not be effective for purposes of invoking the business judgment standard of review if it were based on disclosure that contained material misstatements or omissions.

the minority vote serves as a complement to, and a check on, the special committee. An effective special committee, unlike disaggregate stockholders who face a collective action problem, has bargaining power to extract the highest price available for the minority stockholders. The majority of the minority vote, however, provides the stockholders an important opportunity to approve or disapprove of the work of the special committee and to stop a transaction they believe is not in their best interests. Thus, to provide sufficient protection to the minority stockholders, the majority of the minority vote must be nonwaivable, even by the special committee.[39] Moreover, requiring approval of a majority of all the minority stockholders assures that a majority of the minority stockholders truly support the transaction, and that there is not actually "passive dissent" of a majority of the minority stockholders.[40]

To give maximum effect to these procedural protections, they must be pre-conditions to the transaction. In other words, the lack of such requirements cannot be "cured" by the fact that they would have been satisfied if they were in place. This increases the likelihood that those seeking the approval of the minority stockholders will propose a transaction that they believe will generate the support of an actual majority of the minority stockholders. Moreover, a clear explanation

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[39] *See In re JCC Holding Co.*, 843 A.2d 713, 724-25 n.33 (Del. Ch. 2003); *see also Gesoff v. IIC Indus., Inc.*, 902 A.2d 1130, 1150 n.121 (Del. Ch. 2006); *In re Pure Res.*, 808 A.2d at 445.

[40] *See In re PNB Holding Co. S'holders Litig.*, 2006 WL 2403999, at *15 (Del. Ch. Aug. 18, 2006).

of the pre-conditions to the Merger is necessary to ensure that the minority stockholders are aware of the importance of their votes and their ability to block a transaction they do not believe is fair. Accordingly, entire fairness is the appropriate standard of review in this case.

*C. The Entire Fairness of the Merger*

The concept of entire fairness has two components: fair dealing and fair price. These prongs are not independent, and the Court does not focus on each of them individually.[41] Rather, the Court "determines entire fairness based on all aspects of the entire transaction."[42] Fair dealing involves "questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained."[43] Fair price involves questions of "the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock."[44] That the special committee approval and the majority of the minority vote were not sufficient to invoke the

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[41] *Valeant Pharms. Int'l v. Jerney*, 921 A.2d 732, 746 (Del. Ch. 2007) ("[T]he fair dealing prong informs the court as to the fairness of the price obtained through that process.").

[42] *Id.*

[43] *Emerald Partners v. Berlin*, 787 A.2d 85, 97 (Del. 2001) (quoting *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983)).

[44] *Id.* (quoting *Weinberger*, 457 A.2d at 711).

business judgment standard of review does not necessarily mean that defendants will be unable to prevail on the issue of fair dealing.

Hammons contends that he is entitled to summary judgment even if entire fairness is the applicable standard of review. Hammons asserts that he received less than $24 per share for his Class B shares and did not receive any consideration at the expense of the minority stockholders. In support of this assertion Hammons relies on Lehman's opinion that Hammons received less than $24 per share in actual value for his Class B shares and therefore received less per share than the minority stockholders. Plaintiffs, however, attack Lehman's opinion. For example, plaintiffs criticize Lehman's decision to value the $275 million line of credit at only $20 to $30 million dollars based on the cost to Hammons of a theoretical line of credit obtained in the market, notwithstanding that such a line of credit would not, in fact, have been available to Hammons in the open market. Plaintiffs also contend that Lehman erred by failing to account for the significant tax benefits Hammons received and the other benefits Hammons received that Lehman determined "do not have a quantifiable valuation from a financial point of view." Finally, plaintiffs contend that Lehman's analysis is not determinative on the issue of fair price because it does not account for the impact of Hammons's tax and other specialized requirements on the price obtained for the minority

stockholders.[45] These factual and legal disputes regarding the persuasive value of Lehman's opinion on the issue of fair price preclude entry of summary judgment in defendants' favor on that issue.

Because entire fairness is the appropriate standard of review and because there are material factual issues as to the fairness of the price, Hammons's motion for summary judgment on that issue is denied.[46] Similarly, the director defendants' motion for summary judgment on that issue is also denied.[47]

Plaintiffs contend that they have established that the Merger process involved unfair dealing, thus leaving for trial only the issue of fair price. Plaintiffs also argue that the special committee was not effective because the special committee was "coerced" to accept Hammons's offer to avoid the "worse fate" of a continuing presence of minority stockholders. I am not convinced that the special committee was ineffective merely based on the fact that Hammons was able to veto any transaction. In the first instance, there is no requirement that Hammons sell his shares. Nor is there a requirement that Hammons sell his shares

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[45] Plaintiffs maintain that "[t]he injury to the Class is measured not by the benefit to Mr. Hammons, but by the loss suffered by Class members as a result of the personal, self-serving requirements he imposed." Pls.' Opening Br. 54.

[46] The disclosure claims, which are also addressed in Hammons's motion for summary judgment and the director defendants' motion for summary judgment, are addressed below.

[47] *See Emerald Partners*, 787 A.2d at 93-94 ("[W]hen entire fairness is the applicable standard of judicial review, a determination that the director defendants are exculpated from paying monetary damages can be made only *after the basis* for their liability has been decided."); *LNR Property*, 896 A.2d at 178 & n.54 (declining to dismiss claims on the basis of 8 *Del. C.* § 102(b)(7) exculpatory provision because "the entire fairness standard of review may be applicable, and, thus, 'the inherently interested nature of those transactions [may be] inextricably intertwined with issues of loyalty.'") (quoting *Emerald Partners*, 787 A.2d at 93).

to any particular buyer or for any particular consideration, should he decide in the first instance to sell them. There is no requirement that Hammons agree to a transaction that would have adverse tax implications for him. If Hammons chose not to sell his shares, the minority stockholders would have remained as minority stockholders. The mere possibility that the situation would return to the status quo, something Hammons could have chosen to do by never considering selling his shares, is not, standing alone, sufficient "coercion" to render a special committee ineffective for purposes of evaluating fair dealing.

Plaintiffs also contend, however, that the price of the minority shares before the Merger was depressed as a result of Hammons's improper self-dealing transactions. Defendants contend that any "undervaluing" of the shares merely represents the lack of control premium attributable to a minority position in the Company. I am unable, on the current record, to resolve this factual dispute, and neither plaintiffs nor defendants are entitled to summary judgment on the issue of fair dealing. Plaintiffs could prevail at trial on the issue of fair dealing if they were able to establish that the price of the minority shares was depressed as a result of Hammons's improper self-dealing conduct. If the price were depressed as a result of such conduct, then the special committee and the stockholders could have been subject to improper coercion, meaning they would have been coerced into accepting any deal, whether fair or not, to avoid remaining as stockholders. This

result addresses the concern that majority stockholders may have an incentive to depress the price of minority shares through improper self-dealing so they could then buy out the minority at a low price. As explained above, however, the issues of whether the price of the minority shares was depressed as a result of such conduct, and whether, as a result, the special committee or the minority stockholders were improperly coerced into accepting the Merger, must remain for trial. Accordingly, neither plaintiffs nor defendants are entitled to summary judgment on the issue of fair dealing.[48]

*D. The Disclosure Claims*

As noted above, plaintiffs agree that a number of disclosure violations previously alleged should be withdrawn, but continue to assert that the proxy statement contained four misstatements and omissions. Plaintiffs maintain that the proxy statement mischaracterized the special committee process, omitted information regarding the alleged conflicts of interest of Lehman and Katten Muchin, and omitted information regarding a presentation Eilian made to the

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[48] Although the procedural protections used in this case were not sufficient to invoke business judgment protection, they could have been sufficient to shift the burden of demonstrating entire fairness to plaintiffs. As explained below, some of plaintiffs' disclosure claims have survived summary judgment. Accordingly, at this stage, I cannot conclude that the majority of the minority vote shifts the burden of demonstrating entire fairness to plaintiffs. Because of the material issues of fact that remain, I also leave open the question whether the special committee's process and approval were sufficient to shift the burden of entire fairness to plaintiffs.

special committee. Defendants seek summary judgment on the disclosure claims.[49]

The fiduciary duty of disclosure, which is a specific formulation of the duties of care and loyalty, requires the Board to "disclose fully and fairly all material information within the board's control . . . ."[50] To succeed on their disclosure claims, plaintiffs must identify the facts allegedly omitted from the proxy statement and "state why they meet the materiality standard and how the omission caused injury."[51] "An omitted fact is material if there is a substantial likelihood that a reasonable stockholder would consider it important in deciding how to vote."[52] In other words, "there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable stockholder as having significantly altered the 'total mix' of information made

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[49] Defendants cite *In re Transkaryotic Therapies, Inc.*, 954 A.2d 346 (Del. Ch. 2008) and argue that they are entitled to summary judgment because there is no longer a remedy available for any of the alleged disclosure violations. Entire fairness, however, is the appropriate standard of review in this case, and because of the issues of loyalty "intertwined" with transactions subject to such a standard, this is not a case in which the Court will refrain from granting relief for disclosure violations because the transaction has been completed. *See LNR Property*, 896 A.2d at 178 & n.54. In other words, this is not a case "where there is no evidence of a breach of the duty of loyalty or good faith by the directors who authorized the disclosures." *Transkaryotic*, 954 A.2d at 362; *see Emerald Partners*, 787 A.2d at 93-94. Similarly, the Board is not entitled to summary judgment at this stage under the Company's 8 *Del. C.* § 102(b)(7) exculpatory provision. *See LNR Property*, 896 A.2d at 178 & n.54; *Emerald Partners*, 787 A.2d at 93-94.

[50] *Skeen v. Jo-Ann Stores, Inc.*, 750 A.2d 1170, 1172 (Del. 2000) (quoting *Stroud v. Grace*, 606 A.2d 75, 84 (Del. 1992)).

[51] *Id.* at 1173 (*Loudon v. Archer-Daniels-Midland Co.*, 700 A.2d 135, 141 (Del. 1997)).

[52] *Loudon*, 700 A.2d at 143.

available."[53] Of course, "[u]nsupported conclusions and speculation are not a substitute for facts."[54]

First, plaintiffs contend that the proxy statement "mischaracterized the Special Committee process as effective and independent of Mr. Hammons" and that "[b]y failing to convey the subservient, deferential approach adopted by the Special Committee, JQH's minority shareholders were led to believe that the price achieved resulted from an effective, arm's length process and not from the constrained, coerced posture occupied by the Special Committee."[55]

Even interpreting the facts in plaintiffs' favor, I am not convinced that they have stated a claim based on the failure to disclose the "subservient, deferential approach adopted by the Special Committee." Plaintiffs point to no specific factual misrepresentation or misleading disclosure in the proxy statement. Rather, plaintiffs seek to have defendants disclose their characterization of the special committee process. This Court has clearly held that directors are not required to disclose the plaintiffs' characterization of the facts or engage in "self-flaggelation."[56] Here, I cannot conclude that defendants violated the duty of

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[53] *Skeen*, 750 A.2d at 1172 (quoting *Loudon*, 700 A.2d at 143) (internal quotation marks omitted).
[54] *Id.* at 1173.
[55] Pls.' Opening Br. 67.
[56] *Khanna v. McMinn*, 2006 WL 1388744, at *29, 34 (Del. Ch. May 9, 2006) ("A long-standing principle of disclosure jurisprudence provides that a board need not engage in 'self-flagellation.' Notwithstanding the requirement that directors disclose fully all material facts in the solicitation of proxies from shareholders, a board of directors is not required to 'confess to wrongdoing prior to any adjudication of guilt,' nor must it 'draw legal conclusions implicating itself in a breach of

disclosure by failing to describe the special committee as "subservient" or "deferential." The proxy statement describes the special committee process and even includes disclosure of the special committee's recognition that it lacked the authority and ability to broadly market the Company in light of Hammons's ability to block any transaction and that Hammons's interest in any transaction would be influenced by, among other things, tax implications personal to Hammons and different from those of the minority stockholders. Given this disclosure and the thorough description of the other aspects of the special committee process, Delaware law does not require that the proxy statement include plaintiffs' characterization of the special committee process.[57] Accordingly, summary judgment is granted in favor of defendants on this claim.

Plaintiffs also bring a claim based on the failure to disclose that Lehman faced a potential conflict of interest because it had contacts with Eilian about the possibility of underwriting the nearly $700 million commercial mortgage-backed security offering planned by Eilian after completion of the Merger. Plaintiffs contend that the possibility of getting this business gave Lehman a powerful incentive to approve the transaction.

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fiduciary duty from surrounding facts and circumstances prior to a formal adjudication of the matter.'") (footnotes omitted); *In re MONY Group, Inc. S'holder Litig.*, 853 A.2d 661, 682 (Del. Ch. 2004) ("'[A]s a general rule, proxy materials are not required to state 'opinions or possibilities, legal theories or plaintiff's characterization of the facts.'") (quoting *Seibert v. Harper & Row, Publishers, Inc.*, 10 Del. J. Corp. L. 645, 655, 1984 WL 21874, at *6 (Del. Ch. Dec. 5, 1984)).

[57] *See In re Lear Corp. S'holder Litig.*, 926 A.2d 94, 111 (Del. Ch. 2007).

Defendants contend that the group at Lehman that had contact with Eilian about the debt refinancing was different from the group advising the special committee and that Lehman did not ultimately get the business. This Court, however, has stressed the importance of disclosure of potential conflicts of interest of financial advisors.[58] Such disclosure is particularly important where there was no public auction of the Company and "shareholders may be forced to place heavy weight upon the opinion of such an expert."[59] It is imperative that stockholders be able to decide for themselves what weight to place on a conflict faced by the financial advisor.

Defendants further contend that "there is no evidence that Lehman's opinion was affected by the purported pitch."[60] There is no rule, however, that conflicts of interest must be disclosed only where there is evidence that the financial advisor's opinion was actually affected by the conflict. Thus, defendants cannot defend the alleged omission as immaterial by arguing that any contacts between Lehman and Eilian regarding the refinancing occurred after Lehman opined in December 2004 that the then-high bid of $21 per share was fair to the minority stockholders. By an

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[58] *See David P. Simonetti Rollover IRA v. Margolis*, 2008 WL 5048692, at *8 (Del. Ch. June 27, 2008) ("[I]t is imperative for the stockholders to be able to understand what factors might influence the financial advisor's analytical efforts. . . . A financial advisor's own proprietary financial interest in a proposed transaction must be carefully considered in assessing how much credence to give its analysis.").

[59] *Braunschweiger v. Am. Home Shield Corp.*, 17 Del. J. Corp. L. 206, 217, 1991 WL 3920, at *6 (Del. Ch. Jan. 7, 1991).

[60] Def. John. Q. Hammons's Reply in Supp. of His Mot. For Summ. J. & Opp'n to Pls.' Mot. for Partial Summ. J. 17.

extension of the logic underlying this argument (that a conflict is not material because the current bid is higher than a bid that was previously found fair by the financial advisor), Lehman's continued engagement after the $21 bid was wholly unnecessary so long as any subsequent bid was not below $21. If this is not the case—if Lehman's judgment was still valuable and necessary even after the opinion on the $21 bid—then the financial advisor's conflict of interest would need to be disclosed in the proxy statement. There remain important factual issues about the timing and content of any contact between Lehman and Eilian regarding the refinancing, as well as whether the Board knew or should have known of the alleged conflict. Defendants, therefore, are not entitled to summary judgment on this claim.

Plaintiffs also assert a claim based on the failure to disclose Katten Muchin's representation of iStar. iStar is the firm that provided Eilian the financing to complete the Merger, and plaintiffs contend that iStar played a substantial role in negotiations between Hammons and Eilian. Plaintiffs argue that this conflict gave Katten Muchin an incentive to see the Merger proceed with Eilian. The special committee was informed of the conflict and that iStar would be represented by a separate team of attorneys at Katten Muchin that was prohibited from discussing the matter with the team of attorneys advising the special committee. The special committee discussed the matter and unanimously approved the representation and

agreed that the matter would not compromise Katten Muchin's independence. The conflict, however, was not disclosed to stockholders in the proxy statement.

Again, the compensation and potential conflicts of interest of the special committee's advisors are important facts that generally must be disclosed to stockholders before a vote. This is particularly true, where, as here, the minority stockholders are relying on the special committee to negotiate on their behalf in a transaction where they will receive cash for their minority shares. Although the waiver of the conflict by the special committee may have resolved any ethical violation, the special committee's waiver of the conflict would likely be important to stockholders in evaluating the Merger and in assessing the efforts of the special committee and its advisors. For these reasons, defendants are not entitled to summary judgment on this claim.

Finally, plaintiffs bring a claim based on the failure to disclose in the proxy statement a presentation Eilian made to the special committee. The presentation, which was made to the special committee in November 2004, included a valuation of JQH shares from $35.37 to $43.01 based on the average of "peer multiples." Defendants contend that the valuation was based on a hypothetical scenario in which the Company remained public but was transformed into a new entity under Eilian's management. Plaintiffs assert that although the presentation lists several factors that result in JQH's share price being below peer multiples, the presentation

does not describe the valuation as contingent on any of these hypothetical factors. Plaintiffs also contend that none of the factors listed are proper grounds for a discount from fair value under Delaware law.

After reviewing the presentation and the minutes of the November 18, 2004 special committee meeting, it is not clear to the Court whether or not the valuation in the presentation was based on a "hypothetical" scenario in which the company remained public with Eilian taking control. If the valuation was not contingent on such a hypothetical scenario, then it appears to be information that a reasonable stockholder would find relevant in determining whether to vote to approve Eilian's $24 per share offer. If, on the other hand, the valuation in the presentation was based on such a hypothetical transaction—a transaction the Board likely could have determined in good faith was highly unlikely given Hammons's objectives—then the Board would likely not have violated their duty of disclosure by failing to disclose the presentation in the proxy statement. Accordingly, defendants are not entitled to summary judgment on this claim.

*E. The Aiding and Abetting Claims*

Plaintiffs assert a claim against Acquisition and Merger Sub for aiding and abetting a breach of fiduciary duty. To prevail on an aiding and abetting claim, a plaintiff must establish "'(1) the existence of a fiduciary relationship, (2) a breach of the fiduciary's duty, . . . (3) knowing participation in that breach by the

defendants,' and (4) damages proximately caused by the breach."[61] As a controlling stockholder, Hammons owed fiduciary duties to the minority stockholders, and the issue of fair dealing and fair price cannot be decided on summary judgment and therefore must remain for trial. Defendants assert that they are entitled to summary judgment on this issue because there is no evidence that Eilian's entities knowingly participated in a breach of fiduciary duty.

"Knowing participation in a board's fiduciary breach requires that the third party act with the knowledge that the conduct advocated or assisted constitutes such a breach."[62] Eilian was intimately involved in the negotiations and structuring of the transaction and understood that Hammons and the minority stockholders were in a sense "competing" for the consideration he would pay to acquire JQH. An offeror, however, may bargain at arm's-length for the lowest possible price, and Eilian was permitted to negotiate both with Hammons and the special committee, so long as he did not have knowledge that those negotiations and the resulting transaction would cause a breach of duty to the minority stockholders. As noted above, plaintiffs contend that Hammons's improper self-dealing conduct depressed the price of the minority shares, and plaintiffs could prevail at trial on the issue of fair dealing if they were able to make such a

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[61] *Malpiede v. Townson*, 780 A.2d 1075, 1096 (Del. 2001) (quoting *Penn Mart Realty Co. v. Becker*, 298 A.2d 349, 351 (Del. Ch. 1972)).
[62] *Id.* at 1097.

demonstration. Plaintiffs cite evidence that Eilian was aware of those conflicts and that they may have had an effect on the price of the minority shares. For example, plaintiffs point to Eilian's October 28, 2004 letter to the special committee, which cited "[p]erceived conflicts of interest with the controlling Class B shareholder" as an explanation for the underperformance of JQH shares, and Eilian's November 17, 2004 presentation that cited "unique issues of controlling shareholder" as a source of the Company's trading discount. Accordingly, there remains a material issue of fact as to whether Eilian was aware that JQH's stock price was depressed as a result of Hammons's improper self-dealing conduct. Accordingly, defendants are not entitled to summary judgment on this claim.

## III. CONCLUSION

For the foregoing reasons, defendants' motions for summary judgment are granted in part and denied in part, and plaintiffs' motion for partial summary judgment is granted in part and denied in part. Counsel shall confer and submit a form of order that implements the rulings described above.

IT IS SO ORDERED.