09/17/96 PAINE WEBBER LIMITED PARTNERSHIPS

1996 | Cited 0 times | Court of Chancery of Delaware | September 17, 1996

JACOBS, VICE CHANCELLOR

The plaintiffs in this action, Liquidity Fund 33, L.P., Liquidity Fund 34, L.P., and Liquidity Fund 53, L.P. (collectively, the "plaintiffs") seek a court-ordered list of the limited partners of certain Paine Webber-affiliated limited partnerships. [1] Specifically, the plaintiffs seek a list of the names, addresses, and ownership interests of all of the limited partners of each of the defendant limited partnerships (the "lists"). In a series of letters beginning on October 13, 1995 and ending on or about May 24, 1996, plaintiffs formally demanded the lists from the defendant limited partnerships. Those requests were denied, and on June 6, 1996 this action was filed.

The Court concludes that, in these particular circumstances, (1) the plaintiffs do not have a statutory right to the lists, because they have not established a proper statutory purpose as required by 6 Del.C. § 17-305; and (2) the plaintiffs do have a contractual right to the lists under the applicable Partnership Agreements. In arriving at that result, the Court declines to imply an "improper purpose defense" as a term of those Partnership Agreements. The Court also finds that even if such a defense could be implied, the defendants have failed to establish it in this case. Accordingly, for the reasons discussed more fully below, the plaintiffs are entitled to the relief that they seek under the Partnership Agreements.

I. FACTS

A. The Parties

The plaintiffs are California limited partnerships that were organized to invest in real estate properties. Liquidity Financial Group, L.P. ("Liquidity Financial") is a California limited partnership that serves as the sole general partner of each of the plaintiff limited partnerships. Liquidity Financial Corporation, a California corporation, is the sole general partner of Liquidity Financial. Mr. Brent Donaldson ("Donaldson"), Liquidity Financial Corporation's President, controls the plaintiff limited partnerships.

The defendants are Delaware limited partnerships that were organized by Paine Webber, the investment banking firm, for the purpose of making real estate investments. Also named as defendants are the general partners of the defendant limited partnerships. Each of these general partners is indirectly managed by a Paine Webber affiliate.

B. The Requests for the Lists

On October 13, 1995, Liquidity Financial requested a list of the names and addresses of the limited partners, and the number of units held by each, in the defendant limited partnerships. At that particular point in time, Liquidity Financial's stated purpose was "to enable it to communicate with other Limited Partners with respect to issues of Partnership business and to assess the strength of the market for and thus the value of, its investment in the Partnership." Pl. Ex. 15.

Liquidity Financial was asked to clarify its purpose on October 23, 1995, and by letter dated November 13, 1995, it responded that it desired "to hold complete files on all of [its] investments." Pl. Ex. 14. Liquidity Financial added that though it had utilized such lists in the past to inform investors of its interest in negotiating separate purchases, it had not used the lists for that purpose or in that manner since 1993. By letter dated November 30, 1995, the defendants denied the plaintiffs' request for the lists.

Liquidity Financial made a second request for the lists by letter dated December 6, 1995. That letter stated no purpose for seeking the lists. It did, however, prompt a series of somewhat antagonistic telephone calls between Mr. Donaldson and Paine Webber's Vice President of Investor Relations. The lists were not produced.

Liquidity Financial's third written request for the lists was made in a letter dated January 8, 1996. In that letter, Liquidity Financial repeated its stated purpose as of October 23, 1995, viz., to have complete files on all of its investments. Liquidity Financial also advised that in the past that it had used investor lists to communicate with other limited partners about partnership business, to value its investments, and to negotiate separate purchases of limited partnership interests, but at this time it had no immediate plans to contact any of the limited partners. By letter dated January 22, 1996, the defendants rejected that request as well.

In a letter dated February 1, 1996, Liquidity Financial again requested the lists. That letter did not state any purpose for the request, and no lists were produced.

Liquidity Financial made its final request for the lists in separate letters, all dated May 24, 1996, to each of the five defendant limited partnerships. In those letters, Liquidity Financial advised that it wanted the lists "to assist [it] in determining whether to seek additional interests." Pl. Exs. 1-5. The defendants refused to furnish the lists and this action followed.

II. DECISION

In this action, the plaintiffs claim both a statutory and a contractual right to the limited partner lists. [2] Those two claims are addressed seriatim.

A. The Plaintiffs' Statutory Claim

The plaintiffs first claim an entitlement to the lists pursuant to 6 Del.C. § 17-305, which requires that the limited partner requesting the information have a purpose "reasonably related to the limited partner's interest as a limited partner. " § 17-305(a). Plaintiffs concede that they have the burden of proof on this issue, but insist that their stated purposes and their proof at trial satisfy that burden.

The statutory claim implicates two issues, one factual and the other legal: 1) what is the plaintiff's true purpose, and 2) is that purpose sufficient under § 17-305?

1. The Plaintiffs' True Purpose

Despite repeated requests from the defendants, Liquidity Financial (and, more specifically, Mr. Donaldson) has never settled upon any clear and firm purpose for seeking the lists. Liquidity Financial's various letters demanding the lists reveal a cornucopia of often incongruous, ever-shifting purposes. Indeed, at one point, Mr. Donaldson asked the defendants to provide him examples of proper purposes from which he could then choose. Mr. Donaldson's deposition and trial testimony did little to clarify Liquidity Financial's true purpose. For example, one of the stated purposes in some of the plaintiffs' demand letters and in the plaintiffs' pre-trial brief was valuation of the partnership interests. Yet in his trial testimony, Mr. Donaldson omitted any reference to valuation, and in response to questions by the Court, he admitted that valuation was "an ancillary reason, but ... certainly not for most [sic] in my mind." Tr. 157-58. The plaintiffs' resistance in committing to any definite purpose creates the unavoidable impression of a studied effort to contrive a purpose -- any purpose -- that a court could find legally sufficient, while at the same time "hiding the ball" regarding their true purpose. That impression does little to enhance the credibility of the plaintiffs' case.

The Court made a final attempt to divine the plaintiffs' purpose at the post-trial oral argument. In response to the Court's questions, plaintiffs' counsel represented that (1) the plaintiffs' "contract" purpose (i.e., the purpose advanced in connection with their contract claim) was that they wanted to be prepared to communicate with the other limited partners at a future time about (unspecified) partnership business, and that (2) the plaintiffs' "statutory" purpose was to conduct a survey to help plaintiffs decide whether or not to increase their ownership of units in the defendant limited partnerships by way of a tender offer. [3]

The trial, however, was when the true nature of the plaintiffs' primary purpose came to light. Mr. Donaldson admitted that if any tender offer were to be made, it would be conducted not by the plaintiffs directly, but, rather, by an as-yet-to-be-created $50 million investment fund (the "investment fund"). Tr. at 134-36. In his pre-trial deposition Mr. Donaldson testified that it had not been determined whether the plaintiffs would even participate in any of those purchases. Def. Ex. 22 at 136-37. What did become clear was that if the plaintiffs were to participate in any tender offer by

the investment fund, that participation would be de minimis because the three plaintiff partnerships do not have significant available cash. [4] Finally, Mr. Donaldson testified at trial that any participation by the plaintiffs may take the form of their furnishing the lists to the investment fund in exchange for an equity participation in that fund. Tr. at 134, 143.

The plaintiffs insist that any tender offer by the investment fund would be incidental, and that the plaintiffs' primary purpose in seeking the lists is to conduct a survey to decide whether or not to acquire additional partnership units. However, the economic rationale for conducting such a survey is dubious: Mr. Donaldson conceded that such surveys cost approximately $4,000 to $5,000, and that there were other ways to value a small investment. The plaintiffs could suggest no reason why they would commit to that expense where they would be, at best, minor participants in any tender offer. In the Court's view, given the lack of significant funds available to plaintiffs, and given Mr. Donaldson's testimony that the plaintiffs may not even participate in any tender offer, incurring the expense of such a survey would be worthwhile only to the investment fund that would conduct the tender offer. For these reasons, I conclude that the plaintiffs' primary purpose for seeking the lists of limited partners is not to conduct a survey. Rather, it is to make the lists available to the investment fund in return for an equity participation in that fund, should it ever be created.

2. The Legal Sufficiency of the Plaintiffs' Purposes

The plaintiffs' true purposes having been determined, the question then becomes whether they are legally sufficient under § 17-305. Plaintiffs acknowledge that a desire to be prepared to communicate with fellow limited partners about unspecified topics at some unspecified future time, is not a proper statutory purpose. See Northwest Indus. v. B.F. Goodrich Co., Del. Supr., 260 A.2d 428 (1969); Hatleigh Corp. v. Lane Bryant, Inc., Del. Ch. C.A. No. 6259, Hartnett, V.C. (Oct. 20, 1980); AAR Corp. v. Brooks & Perkins, Inc., Del. Ch., C.A. No. 6222, Brown, V.C., Letter Op., (Aug. 12, 1980). Thus, the analysis must center on the plaintiffs' other ("contract") purpose -- i.e., the plaintiffs' intent to furnish the lists to the (yet to be formed) investment fund.

The desire to obtain a shareholder list in order to sell it for commercial purposes has long been considered improper under 8 Del. C § 220, which is the corporate analogue to § 17-305. Theile v. Cities Service Co., Del. Supr., 31 Del. 514, 115 A. 773 (1922); Tannetics, Inc. v. A. J. Indus., Del. Ch., C.A. No. 4592, Marvel, V.C. (Sept. 4, 1974) Plaintiffs have suggested no reason why that purpose is any less improper in the partnership context.

Plaintiffs contend that they would not be "selling" the lists, but, rather, would be "using" them as a means to participate in a potential tender offer. That, plaintiffs argue, is similar to a stockholder seeking a stockholder list in order to value his stock, to help him decide whether to sell his shares, or to purchase additional shares. Delaware courts have found that purpose to be proper under § 220. See BBC Acquisition v. Durr-Fillauer Medical, Del. Ch., 623 A.2d 85 (1992); CM & M Group, Inc. v. Carroll, Del. Supr., 453 A.2d 788 (1982). The problem with that argument is that it lacks credibility in

this context: even if the plaintiffs decide to participate in the investment fund that conducts the tender offer, their participation would be minimal.

Plaintiffs' response is that the size or magnitude of the plaintiffs' investment is legally irrelevant, and for support they rely upon Hirschfeld v. Emery Air Freight Corp., Del. Ch., C.A. No. 9806, Hartnett, V.C., Mem. Op., (Apr. 22, 1988). Plaintiffs' reliance is misplaced. In Hirschfeld, the plaintiffs sought a stockholder list in order to give it to another person (Mr. Bass), who planned to use the list to wage a proxy contest to gain control of the board. The Court found that even though Mr. Hirschfeld's role was strictly supportive, his bona fide purpose in helping Mr. Bass was to help elect an opposition slate committed to implementing policies that could ultimately increase the value of his shares. Consequently, that purpose was found to be proper.

Here, in contrast to Hirschfeld, the plaintiffs have no plans to use the lists to increase the value of their current investments in the defendant limited partnerships. Rather, Mr. Donaldson and Liquidity Financial are using the plaintiffs' nominal investment in the defendant limited partnerships [5] purely as a legal vehicle to obtain the lists in anticipation of a possible tender offer, to be conducted by a separate entity and in which the plaintiffs' participation would at best be token. Thus, the use of the lists to aid in that tender offer is a purpose that relates solely to the investment fund's interest as a potential buyer, not to the plaintiffs' interest as limited partners. That purpose is therefore not proper under § 17-305. See BBC Acquisition v. Durr-Fillauer Medical, Inc., Del. Ch., 623 A.2d 85 (1992); Badger v. Tandy Corporation, Del. Ch., C.A. No. 6898, Duffy, J. (Mar. 24, 1983) (denying relief under § 220 for stockholder list where the plaintiff's purpose was to sell the information to fellow stockholders who were unaware that they owned such stock).

Because neither of the plaintiff's purposes for requesting the lists of limited partners is proper, plaintiffs have failed to demonstrate their entitlement to the lists under the statute. [6]

B. The Plaintiffs' Contract Claim

1. The Partnership Agreements

Because the plaintiffs have no statutory right to the lists, any entitlement they may have must flow from the Partnership Agreements. The relevant provision(s) of those Agreements state as follows:

Books and Records.

A. Books and records of the Partnership shall be maintained at the principal office of the Partnership or at any other place designated by the General Partner and shall be available for examination there by any Partner or his duly authorized representatives at any and all reasonable times. The Partnership may maintain such books and records and may provide such financial or other statements as the General Partner in its sole discretion deems advisable. Any Partner, or his duly

authorized representatives, upon paying the costs of collection, duplication and mailing, shall be entitled to a copy of the list of the names and addresses of the Limited Partners (including the number of Units owned by each of them).

Pl. Ex. 7, at § 11.1; Pl. Ex. 8, at § 11.1; Pl. Ex. 9, at § 10.1; Pl. Ex. 10, at § 10.1; Pl. Ex. 11, at § 11.1.

No language in the above-quoted provision(s) requires a showing of a proper purpose. On their face the Partnership Agreements give plaintiffs the unqualified right to the lists they request without regard to purpose. The defendants contend, however, that the Court must read into the Agreements the proper purpose requirement contained in § 17-305 or, alternatively, should infer an "improper purpose defense" as an implied contractual term. For the reasons now discussed, neither argument has merit.

2. The Argued-For Role of § 17-305

The Defendants first argue that the purpose requirements of § 17-305 must be read into the Partnership Agreements. Their purpose, simply put, is that the statute, which contains a proper purpose requirement, "trumps" any partnership contract that does not. I conclude that there is no basis for this contention.

An important policy underlying the Delaware Revised Uniform Limited Partnership Act (the "Act") is to give maximum effect to the principles of freedom of contract and the enforceability of partnership agreements. 6 Del.C. § 17-1101(c). The Act provides that any partner's duties and liabilities to a limited partnership or to another partner may be expanded or restricted by contract provisions in the partnership agreement. 6 Del.C. § 17-1101 (d). Despite this policy, defendants would have this Court imprint a proper purpose requirement upon Partnership Agreements that impose no such condition. No legal justification for doing that is shown.

In addition to abridging the parties' freedom of contract, the judicial addition of a proper purpose requirement into the Partnership Agreements would create an anomalous inconsistency with our corporation law. This Court has enforced a stockholders' agreement that expands the rights of the contracting stockholders to obtain a stockholder list beyond those rights conferred by § 220. Such an agreement was recognized as creating "additional [enforceable] rights beyond those created by § 220." Ostrow v. Bonney Forge Corp., Del. Ch., C.A. No. 13270, Allen, C. (Apr. 6, 1994), Mem. Op. at 10. By analogy to the shareholders agreement upheld in Bonney Forge, the Partnership Agreements in this case have expanded the limited partners' statutory right to obtain lists of the limited partners by not requiring a showing of a proper purpose. Under the defendants' "statutory incorporation" argument, equity investors in a limited partnership would be denied any power to contract for such expanded rights, while equity investors in a corporation would have that power. No justification for such a dual standard has been suggested.

Although the defendants argue the contrary, Schwartzberg v. CRITEF Assocs, Ltd. Partnership, Del. Ch., C.A. No. 14837, Allen C. (June 7, 1996) ("Schwartzberg") does not mandate that the proper purpose requirement of § 17-305 be read into the Partnership Agreements. In Schwartzberg, the plaintiff was both a general partner and a limited partner of one partnership, and a limited partner of another partnership. The plaintiff claimed both a statutory right, and a contractual right, to inspect lists of the partners in both partnerships. Addressing the plaintiff's statutory claim as a limited partner, Chancellor Allen found that the plaintiff had not stated a proper purpose as required by § 17-305. Id., at 19 n.14. However, the Court observed that because neither the partnership agreements nor Section 1519 of the Revised Delaware Uniform Partnership Act (6 Del.C. § 1519) contained an express requirement relating to "purpose", "in [such] instances one must begin with the recognition that a partner has no obligation to prove that it has a 'proper purpose' in order to enforce one of these rights to the prescribed access." Schwartzberg, at 19. [7] Thus, Schwartzberg supports the proposition that this Court should not read § 17-305 into a partnership agreement that grants a limited partner access to partnership information without requiring a demonstration of proper purpose.

3. Inferring an Improper Purpose Defense

Given the absence of language in the Partnership Agreements requiring the plaintiffs to show a proper purpose for their request, this Court would seem bourd to enforce the plaintiffs' unqualified contractual right to inspect the limited partner list. The defendants disagree, asserting that Schwartzberg requires this Court to infer an "improper purpose defense" into the Partnership Agreements. In this particular factual setting, that argument lacks merit.

As the Court stated in Schwartzberg:

The conditions under which an implied contractual obligation may be inferred were narrowly construed by this court in Katz v. Oak Industries, Inc., Del. Ch., 508 A.2d 873 (1986); see also E.I. DuPont De Nemours and Co. v. Pressman, Del. Supr., C.A. No. 35, 1995, Veasey, C.J. (May 2, 1996), 1996 Del. LEXIS 179, at *22 (citing Katz with approval on this point). It was there stated that an obligation may be inferred when, given the terms of the express contract made and the circumstances of the contracting process, it is more likely than not ... that if the parties had thought to address the subject, they would have agreed to create the obligation that is under consideration by the court ex post facto.

Schwartzberg, at 20 (emphasis in original).

In this case, the Schwartzberg analysis does not lead to the Conclusion that had the contracting parties thought to address the subject, they would have agreed to allow the partnerships to refuse to produce a list of partners in cases where the partnership could show that the plaintiff's purpose for seeking the list was improper.

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Before September 1, 1985, Delaware limited partnerships were legally required to include a list of limited partners in their publicly-filed certificate of limited partnership. Thus, the identities of the limited partners became a matter of public record. That law was subsequently changed, with the result that from and after September 1, 1985, Delaware limited partnerships were no longer required publicly to file a list of their limited partners. See 65 Del. Laws 188 (1985), amending and restating 63 Del. Laws 420 (1983).

Schwartzberg involved a partner's right to obtain lists of partners of limited partnerships that were formed after 1985 -- after the enactment of the statute that enabled limited partners to maintain their confidentiality. In those circumstances, the Chancellor properly concluded that it was "more likely than not" that had the partners addressed the subject of purpose when they formed the limited partnerships, they would have agreed that the partnership could deny access to the partner list where "the partner seeking access is doing so for a purpose personal to that partner and adverse to the interests. of the partnership considered jointly." Id., at 22. Here, however, because the defendant limited partnerships were formed prior to 1985, this Court cannot conclude that if the persons who negotiated the Partnership Agreements had addressed the subject, they would "more likely than not" have agreed to deny access to the lists that were already a matter of public record.

Defendants argue, however, that (i) the Partnership Agreements are amended by the admission of each new limited partner, and that (ii) because new limited partners joined the defendant limited partnerships after 1985, this Court must determine what agreement the partners would have reached as of the present time when the identity of limited partners is not public record. The flaw in that argument is that the Partnership Agreements require newly admitted limited partners to adopt the Partnership Agreements as stated. [8] Because there is no opportunity to bargain at the time of admission, there is no legal basis to inquire into how the partners would have contracted had they been able to bargain.

Finally, even if this Court were to imply an "improper purpose defense," the defendants have failed to establish that defense in this particular case.

Schwartzberg did not (as defendants argue) blanketly infer a statutory "proper purpose" requirement into all partnership agreements, for to do that would effectively override all partnership agreements that expand the inspection rights conferred by statute by not requiring a showing of proper purpose. The implied improper purpose defense recognized by Schwartzberg is something quite different from the "proper purpose" concept under § 17-305. Schwartzberg holds that in cases when that defense can be implied, inspection relief may be denied if the partnership can demonstrate that the plaintiff partner's purpose (a) is personal to the plaintiff and (b) would actually harm the value of the joint investment. Id., at 21-22 (finding that plaintiff's purpose in requesting a list was to gain leverage against other partners in other pending litigation at considerable risk to the financial welfare of the partnerships). Thus, under Schwartzberg, where the partnership agreement creates an unqualified right to the list, a partner is legally entitled to the list even if its purpose is not proper (i.e., is

personal), unless the partnership can demonstrate that access to the list would also harm the value of the partners' joint investment. [9]

The defendants have failed to make that showing in this case. Although selling the lists to the investment fund would clearly be a purpose personal to the plaintiffs, the defendants have not adduced persuasive evidence that such a sale would harm the value of the partners' joint investment. The defendants claim that the limited partners could be harmed by the plaintiffs' aggressive sales tactics, but even if that assertion were to be credited, defendants have not shown that that conduct would adversely affect (in an economic sense) the defendant limited partnerships as a whole, as distinguished from the limited partners as individuals. Therefore, even if the limited defense recognized in Schwartzberg could be implied, the defendants have failed to establish it here.

III. Conclusion

The plaintiffs have failed to demonstrate their entitlement to a list of the limited partners of the defendant limited partnerships pursuant to 6 Del.C. § 17-305. However, the plaintiffs have established their entitlement to that relief under the Partnership Agreements. Counsel shall confer and submit an appropriate form of order.

1. Those partnerships (collectively, the "defendant limited partnerships) are: Paine Webber Growth Partners, L.P., Paine Webber Income Properties Three, L.P., Paine Webber Qualified Plan Property Fund Two, L.P., Paine Webber Qualified Plan Property Fund Three, L.P., and Paine Webber Qualified Plan Property Fund, L.P.

2. Plaintiffs also claim that by failing to supply the lists, the general partners of the defendant limited partnerships breached their fiduciary duty. Because the plaintiffs cite 6 Del.C. § 17-305 and the Partnership Agreements as the source of that fiduciary duty, this Court's Disposition of the plaintiffs' statutory and contract claims will dispose of their fiduciary duty claim as well.

3. When asked to clarify how the plaintiffs could have one purpose when claiming rights under the statute and another when claiming rights under the Partnership Agreements, plaintiffs' counsel explained that conducting the survey in connection with a possible tender offer was his clients' primary purpose, whereas their desire to maintain complete files "on the shelf" was their secondary purpose.

4. As of year end December 1995, Liquidity Fund 33, L.P., Liquidity Fund 34, L.P., and Liquidity Fund 53, L.P., had cash on hand of approximately $67,000, $70,000 and $140,000, respectively. Tr. 140-42. Although each fund currently has a positive cash flow, Liquidity Financial's historical practice has been to invest each fund's capital at formation, distribute the income earned on those underlying investments when and as earned, and then liquidate the funds once the underlying investments complete their life cycle. Plaintiffs have provided no evidence that Liquidity Financial intends to depart from this historical practice by using the funds' accumulated capital to participate in a future tender offer.

5. Together, the plaintiffs own 0.01%, 0.18%, 0.76%, 1.45% and 2.62% of the units in the five defendant limited partnerships.

6. Plaintiffs also contend that the defendants have not established a defense under § 17-305 (b), which permits a general partner to refuse to furnish limited partner lists if the general partner believes in good faith that disclosure is not in the best interest of the limited partnership. The statutory good faith defense is relevant only if the plaintiffs have established a proper statutory purpose. Because the plaintiffs have not established a proper statutory purpose, it becomes unnecessary to address this defense.

7. In making that observation, the Court was addressing the plaintiff's statutory and contractual claims as a general partner, as well as his contractual claims as a limited partner.

8. Specifically, the relevant section of each Partnership Agreement states: "Each Additional Limited Partner ... shall become a signatory hereof by signing such number of counterpart signature pages to this Agreement and such other instrument or instruments, and in such manner, as the Managing General Partner shall determine. By so signing, each Additional Limited Partner ... shall be deemed to have adopted, and to have agreed to be bound by all the provisions of this Agreement..." Pl. Ex. 7, at § 14.1; Pl. Ex. 8, at § 14.1; Pl. Ex. 9, at § 13.1; Pl. Ex. 10, at § 13.1; Pl. Ex. 11, at § 14.1.

9. Schwartzberg's implied "improper purpose defense" concept may be viewed as a particularized example, in the limited partnership context, of the broader principle that a court of equity may deny specific performance of an established contract right if specific enforcement would cause more harm to the party found to be in breach than to the party seeking enforcement. See Craft Builders, Inc. v. Ellis D. Taylor, Inc., Del. Supr., 254 A.2d 233, 234 (1969) ("Specific performance is purely an equitable remedy, it will not be granted when enforcement of a contract will produce undue hardship"); 71 Am. Jur. 2d, Specific Performance § 73 (1973).