COURT OF CHANCERY
OF THE
STATE OF DELAWARE

DONALD F. PARSONS, JR.
VICE CHANCELLOR

New Castle County CourtHouse
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Wilmington, Delaware 19801-3734

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

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

Dear Counsel:

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

A trial judge has discretion to determine whether or not to grant a stay of discovery.[1] The moving party bears the burden of proving that a stay of discovery is appropriate under the circumstances.[2] "[I]n each instance, the court must make a particularized judgment evaluating the weight that efficiency should be afforded (including the extent of costs that might be avoided) and the significance of any risk of injury to plaintiff that might eventuate from a stay."[3] The policy underlying this rule is that the "expense and time necessary for discovery may be avoided if the motion is granted within a reasonable time."[4]

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

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

2 *Id.*

3 *In re McCrory*, 1991 WL 137145, at *1 (Del. Ch. July 3, 1991).

4 *Stotland v. GAF Corp.*, 1983 WL 21371, at *3 (Del. Ch. Sept. 1, 1983).

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

(ii) where the plaintiff has requested interim relief, and (iii) where the plaintiff will be prejudiced because "information may be unavailable later."[6]

In this case, at least one of these special circumstances exists as to each count of the Complaint, albeit to varying degrees. First, the motion to dismiss does not offer a reasonable expectation of avoiding further litigation over a number of disputes underlying the various counts. In addition, Plaintiffs' requested relief involves elements of exigency analogous to a claim for interim relief in that they seek release of the $25 million from escrow at the earliest possible time.

Based on these factors and my preliminary view that Defendants' motion to dismiss, which remains under advisement, is unlikely to resolve all of Plaintiffs' claims, I GRANT IN PART and DENY IN PART the motion to stay discovery as follows:

1. As to Plaintiffs' claims relating to Defendants' state and local tax ("SALT") claims, the motion to stay discovery is denied to the extent the discovery relates to the adequacy of notice of Defendants' claim under the Stock Purchase Agreement ("SPA") § 7.6 and the Escrow Agreement ("EA") § 3(b), including without limitation the level of specificity required in such a notice, whether the applicable agreements require a written assessment of taxes by a governmental authority, the extent to which any SALT claims against HBW had been asserted, threatened, alluded to or otherwise communicated by any governmental authorities as of November 4, 2004 (the

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[6] *In re McCrory*, 1991 WL 137145, at *1; *Orloff*, 2005 WL 333240, at *1.

date of the last notice letter), and if so, the nature and amount of such claims, and any other facts upon which Defendants might rely to demonstrate the existence of such SALT claim as of November 4, 2004; Defendants' motion to stay discovery as to the SALT claims is GRANTED as to any and all discovery directed to the merits of any SALT claim upon which Defendants' notice of claim may have been based and whether the SALT claim is a "tax claim" and therefore arbitrable. The Court grants a stay of that discovery at this time because there appears to be a reasonable probability that the merits of the SALT claims will need to be addressed in arbitration and the scope of discovery in arbitration may be significantly different from the discovery that would be available in this Court. In addition, for this and the other counts of the Complaint, Plaintiffs' claims of exigency relate primarily to their contention that Defendants improperly caused the escrow period to be extended by filing notices of claims that did not meet the requirements of the applicable agreements.

2. As to Plaintiffs' claims related to Defendants' unclaimed property claims, the motion to stay discovery is denied to the extent the discovery relates to the adequacy of notice of Defendants' claims under SPA § 7.6 and EA § 3(b), including without limitation the level of specificity required in such a notice, whether the applicable agreements require a written assessment of taxes or unclaimed property liability by a governmental authority, the extent to which any unclaimed property claims against HBW had been asserted, threatened, alluded to or otherwise communicated by any governmental authorities as of November 4, 2004 (the date of the last notice letter), and if

so, the nature and amount of such claims, and any other facts upon which Defendants might rely to demonstrate the existence of such unclaimed property claim as of November 4, 2004; the motion to stay is also denied to the extent the discovery relates to whether the unclaimed property claim is a tax claim within the meaning of the applicable agreements and therefore subject to arbitration; Defendants' motion to stay discovery as to the unclaimed property claims is GRANTED as to any and all discovery directed to the merits of any such claim upon which Defendants' notice of claim may have been based.

The Court denies the stay of discovery as to whether an unclaimed property claim is a tax claim because it appears that the Court would benefit from further development of the facts and law related to that issue. The Court grants a stay of discovery as to the merits at this time because there appears to be a reasonable possibility that the merits of the unclaimed property claims will need to be addressed in arbitration and the scope of discovery in arbitration may be significantly different from the discovery that would be available in this Court.

3. As to Plaintiffs' claims relating to Defendants' financial misstatement claim for in excess of $25 million, the motion to stay discovery is denied to the extent the discovery relates to the adequacy of notice of Defendants' claim under SPA § 7.6 and EA § 3(b), including without limitation the level of specificity required in such a notice in terms of the amount of damages, any facts upon which Defendants might rely to demonstrate the basis for their estimate of an amount of damages in excess of $25 million as of November 4, 2004; the motion to stay is also denied as to any and all

discovery directed to the merits of the claim for financial misstatements upon which Defendants' notice of claim may have been based.

The Court denies the stay of discovery on the merits in this instance because this Court has acknowledged that discovery should not be delayed "[i]f discovery is inevitable, either in this forum or another."[7] A stay in such circumstances would not be efficient because the parties would be obligated under the authority of another forum to continue with virtually the same discovery.[8] In this case, Defendants recently filed litigation in federal court in Delaware raising essentially the same financial misstatement claim that gave rise to Plaintiffs' Complaint. In such a situation, the plaintiff may defeat a motion to stay by showing that a stay would potentially increase the discovery work necessary for the parties to litigate their disputes.[9] I believe that possibility exists here and, more importantly, that Plaintiffs efforts to expedite resolution of these disputes would be needlessly thwarted by a stay on the merits of the misstatement claim. Furthermore, I do not consider the differences between discovery in the District Court and the Court of Chancery significant enough to create any material likelihood of wasteful disputes or unnecessary expense. I would expect the parties to agree that discovery provided in one case can be used in the other subject to an appropriate

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

8 *Id.*

9 *Id.*

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

4. The Court grants a stay of discovery as to any challenge to the adequacy of the specificity of the notice as to the nature of the financial misstatement claim based on Plaintiffs' acknowledgement of the adequacy of the notice in that regard.

5. As to Plaintiffs' claims based on HBW's alleged misallocation of $27 million of the purchase price to the noncompetition agreement, the motion to stay discovery is denied to the extent the discovery relates to whether the parties reached any agreement in connection with the SPA or related agreements regarding how the purchase price was to be allocated or what portion, if any, of the consideration was to be allocated to the noncompetition agreement. Defendants' motion to stay discovery is granted, however, to the extent the requested discovery relates to determining the value of the noncompete agreement, through use of experts and other valuation means, or to the tax consequences of any specific allocation.

This Court has jurisdiction to determine whether the parties agreed upon any allocation of the purchase price, including as to the noncompetition agreement.[10]

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[10] *See Stern & Co. v. State Loan & Fin. Corp.*, 205 F. Supp. 702, 705-06 (D. Del. 1962); *Mastan Co. v. Jackson*, 321 F. Supp. 865, 867 (N.D. Ill. 1971)("Although damages in this action will be directly affected by the ultimate determination of the plaintiff's tax liability by the I.R.S., this action is one for breach of warranties and fraud in the sale of securities and corporate assets. This is not an action to confer tax liability upon the defendants."); *King v. United States*, 390 F.2d 894, 914 (Ct. Cl. 1968)("Quite obviously the plaintiff is interested in the tax consequences of his retirement rating. But that does not make it an action with

Defendants dispute this conclusion, arguing that this is a tax dispute that does not fall within the jurisdiction of this Court. Even though Plaintiffs' claim may have tax consequences, the interpretation of the contract as to how much consideration is given to each aspect of the transaction falls within this Courts jurisdiction.

In *Stern*, the defendant argued that pursuant to the Declaratory Judgment Act, 28 U.S.C. § 2201, the court did not have jurisdiction to issue declaratory relief because the controversy was a federal tax dispute, and such disputes are specifically exempted from the scope of the Declaratory Judgment Act.[11] The *Stern* plaintiff countered that the claim was not "with respect to taxes" and was nothing more than "an alleged breach of contract by the other contracting party, which breach plaintiff claim[ed] [would] result in serious consequences of a tax nature to it."[12] In specifically rejecting the defendant's argument that the action concerned federal taxes, the *Stern* court held that while "[t]his court may not determine tax liability; it may determine facts which may have a direct, even immediate, bearing on what the tax liability will be."[13] The court further held that "[t]he fact that plaintiff has 'tax motives' for bringing this suit to

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

11 *Stern*, 205 F. Supp. at 704-05.

12 *Id.*

13 *Id.* at 706.

determine rights of parties under their contract cannot squeeze this action into the statutory exception by virtue of depriving this Court of jurisdiction."[14] Therefore, this Court has jurisdiction to determine how the parties agreed to allocate the consideration (if at all) in the Arias/HBW transaction.

6. Defendants' motion to stay discovery is granted to the extent the discovery relates to Defendants' subjective state of mind or to Plaintiffs' allegations of bad faith as to the SALT claim, the unclaimed property claim and the Defendants' allocation of $27 million to the noncompetition agreement. I have concluded that it would be more efficient and serve the interests of justice to defer discovery on those issues until after the motion to dismiss has been resolved.

7. Based on the foregoing rulings and to the extent the motion to stay has been denied, Defendants shall respond to the outstanding written discovery propounded by Plaintiffs within 15 days of the date of this Letter Opinion and Order.

IT IS SO ORDERED.

Sincerely,

/s/Donald F. Parsons, Jr.

Vice Chancellor

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[14] *Id.*