

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

VENHILL LIMITED PARTNERSHIP, by its)
General Partner, William J. Stallkamp, TRUST)
UNDER AGREEMENT OF DORA B.)
HILLMAN DATED AUGUST 25, 1968 F/B/O)
HOWARD B. HILLMAN, by its Majority)
Trustees, Tatnall L. Hillman and Joseph J. Hill,)
and TRUST UNDER AGREEMENT OF DORA)
B. HILLMAN DATED AUGUST 25, 1968)
F/B/O TATNALL L. HILLMAN, by its Trustees)
Tatnall L. Hillman, Joseph J. Hill and McBee)
Butcher,)

Plaintiffs,)

v.)

C.A. No. 1866-VCS)

HOWARD B. HILLMAN and HMC)
ENTERPRISES, LLC,)

Defendants.)

MEMORANDUM OPINION

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STRINE, Vice Chancellor.

I. Introduction

This case underscores the reality that it is not only greed that can inspire disloyal behavior by a business fiduciary. In fact, when a business fiduciary lives a plush and comfortable life, derived from substantial distributions from family trusts, he can afford to place other considerations — such as the achievement of a personal dream, a desire to prove himself as an entrepreneur and to call himself a CEO, or a stubborn refusal to admit failure — ahead of the prudent pursuit of maximum profit, having a silk-sheeted safety net to fall back upon. In this case, that is just what happened. Defendant Howard Hillman had many years to make Auto-Trol Technology Corporation a success, with the support of substantial investments from trusts benefiting himself and his brother, and their families. At one stage, Auto-Trol had grown its revenues to nearly \$80 million a year and was a publicly listed company.

But its fortune declined rapidly in the early 1990's, until such time as its stock was delisted, its revenues fell to less than \$7 million a year, it became consistently and hugely unprofitable, and it had to go private when its equity had turned into a speculative penny stock. By the late 1990s, Howard Hillman's fellow trustees of key family trusts began to object strenuously to further investments in Auto-Trol, an investment in which the family trusts had poured over \$48 million by 1999. As early as 1996, those trustees told Hillman that they opposed further investment flows into Auto-Trol.

But the trustees did not have direct control over that issue. In 1984, the trusts had formed and funded a limited partnership, Venhill Limited Partnership, to make investments using funds down-streamed from the trusts for that purpose. Howard

Hillman was the sole general partner of Venhill and had sole discretion to make investment decisions on its behalf. Even though the trustees told Hillman that they opposed further investments from Venhill into Auto-Trol, Hillman told them he would continue to fund Auto-Trol. The cash drain of funds flowing from Venhill to Auto-Trol was so great that, under Hillman's control, Venhill needed substantial inflows of capital from its limited partner trusts to meet funding calls for its other private equity and venture capital investments. Despite their stance on loans to Auto-Trol, the trustees continued to fund Venhill with cash from the trusts until December of 1999, knowing full well that Howard would "invest" those funds in Auto-Trol.

Thus, from 1999 to July of 2005, Hillman put another \$37 million into Auto-Trol. He did so on terms that were set entirely by himself and that were far more favorable than Auto-Trol could have ever received in arms-length transactions. That is not surprising as Auto-Trol was insolvent and its shrunken revenues did not cover its substantial expenses. To make Auto-Trol appear solvent, Hillman re-characterized debt Auto-Trol owed to Venhill as equity. He also rolled \$31.5 million in various short-term notes that would come due within three years into a single note maturing in 2020 that would only require interest payments "from time to time." That note reflected his regular practice since 2002 of loaning Venhill funds to Auto-Trol that earned interest at the Applicable Federal Rate, a floating rate set by the federal government available only to the highest quality borrowers. Auto-Trol was a borrower who, by Hillman's own admission, could not obtain debt or equity financing on *any* terms in the market. In total, Hillman made some

186 loans from Venhill to Auto-Trol. Venhill received very little in return, and had invested \$85.4 million at a substantial loss by July of 2005.

At the end of their tolerance, the other trustees of the family trust — Hillman's brother and cousin — finally took action to use the trusts' voting power of Venhill's equity to remove Hillman as general partner. Sensing that his removal was coming, one of Hillman's last acts as general partner was to transfer the majority equity interest of Auto-Trol from Venhill to an entity that Hillman personally controlled for no consideration. Hillman also funneled another \$2 million from Venhill into Auto-Trol as he went out the door.

The inevitable litigation ensued. In this case, the issues have been narrowed. Until shortly after trial, Hillman clung to the untenable position that his actions in transferring control over Auto-Trol from Venhill to himself for nothing was proper. After trial, he abandoned that position and unwound that transaction. Similarly, going into trial, the plaintiffs — the trustees of the various trusts and the new general partner of Venhill on its behalf — sought monetary damages for actions taken by Hillman going back as early as 1993, even though Hillman's intention to continue putting funds into Auto-Trol was understood by all the trustees of the family trusts. On the first day of trial, the plaintiffs finally agreed to limit their request for relief to those actions taken by Hillman within three years of the filing of their complaint on December 30, 2005, abandoning their claims as to prior periods as time-barred.

At trial, the following became clear. From the beginning of the applicable time period in 2002 (and indeed much sooner) until Howard was removed as Venhill's general

partner, Auto-Trol had no plan of business that, to the mind of a rational investor contemplating entrusting equity or debt capital to it, would have provided any rational prospect of success. Given the lack of any realistic plan for future success, and Auto-Trol's past record of business failure, rational private equity investors and lenders would likely not have invested in Auto-Trol on any terms. Absolutely certain is that such rational third-parties would not have lent money to Auto-Trol on terms that corporate borrowers with a AAA credit rating could not obtain. Even more than absolutely certain is that such rational third-parties would not have continued to pour money into Auto-Trol when the prior infusions had done nothing to help the corporation increase its chances for success.

The reason for Venhill's provision of financing to Auto-Trol was singular: Howard Hillman's personal sense of identity was bound up in Auto-Trol. He had served as its CEO since 1985, found its mission interesting, and fervently desired to make it a success, proving to himself and the world that he was capable of generating wealth as an entrepreneur and executive, and not simply by directing family funds into investments identified by another branch of his family, with which he had strained relations.

But Howard Hillman was not pursuing his Auto-Trol dream with his own funds. Instead, he was funding it with Venhill funds that did not belong to him. He was a fiduciary and expected to exercise a rational business judgment about how to invest Venhill's funds. He was expected to make investments that would maximize the returns to Venhill, not that would maximize the personal value he placed on remaining as CEO of Auto-Trol and seeking to make it a success. Likewise, Howard Hillman could not

place his pride above his duty to Venhill. In that respect, it is clear that Hillman was loath to admit to his fellow trustees — his brother and cousin — that Auto-Trol was failing and should be responsibly wound-up unless another financing source could be found.

Instead of exercising his authority as Venhill's general partner for the best interests of Venhill, Hillman irrationally pursued his own agenda by imprudently investing tens of millions of dollars in an insolvent company with no rational plan for future success. He made those investments on terms that were grossly unfair to Venhill, and without any attempt to compare what Venhill would likely receive from investing in Auto-Trol to what it could receive for making other market investments. In fact, it is indisputable that no rational third-party would have invested in Auto-Trol on the terms Hillman caused Venhill to invest. At most, a rational third party might have purchased Auto-Trol's assets for a sum certain, and took what could be salvaged going forward, leaving Auto-Trol's previous investors to enjoy only the modest dent the sales price would make in their huge losses. Put bluntly, Hillman knew he was imprudently investing Venhill's funds by pouring them into a sinking hole, when there were much safer investments available that promised a higher rate of return. Not only that, Hillman knew that he was imprudently concentrating Venhill's investments in Auto-Trol, increasing investments in Auto-Trol to a staggering 63% of Venhill's investments by 2005.

After careful consideration of his testimony and the relevant evidence, I am confident that Hillman knew that what he was doing was imprudent. But he believed that

because of the overall wealth of the trusts and the work he had put in at Venhill that he had an entitlement to pursue his Auto-Trol dream with the funds of his family members. The more they raised concerns, the more stubborn and stuck-in he got regardless of the worsening situation at Auto-Trol, eventually engaging in an outrageous attempt to transfer control of Auto-Trol from Venhill to himself personally when it became clear that his ouster was imminent. In the course of doing that, Hillman caused Venhill to make one last large infusion of funds into Auto-Trol.

Having knowingly pursued his personal objectives over the best interests of Venhill, Hillman acted disloyally and is liable to Venhill for the harm he caused it. At the very least, his conduct was grossly negligent which also suffices to expose him to liability under the terms of Venhill's Limited Partnership Agreement. Finding that all the investments he caused Venhill to make into Auto-Trol from December 30, 2002 to July 26, 2005 were on terms he knew were imprudent and unfair to Venhill, I will require Hillman to repay the principal amount plus a rate of interest approximate to what Venhill would have earned had it used the funds for alternate investments.

II. Factual Background

A certain amount of Hillman family history is essential to a proper understanding of this case. Henry Hillman founded the successful investment firm known as The Hillman Company, which is now a private equity investor in many high technology companies.

Defendant Howard Hillman and his brother Tatnall Hillman joined Henry Hillman's family when Henry married their mother, Dora. Henry became their stepfather

and they took his surname. Henry Hillman had at least one child from his first marriage. The importance of that will become clear soon.

Howard Hillman is now seventy-three years old. He graduated from Princeton University, spent some time in the Navy, and went on to get an M.B.A. from Harvard Business School in 1960. In the early part of his career, he spent nine years as a commercial loan officer at Chemical Bank.

Howard's brother, Tatnall, graduated from Princeton with a biology major, then spent four years as an active duty Naval officer. After that, he taught high school classes for several years in Princeton, New Jersey, and briefly worked as a computer programmer. Therefore, by the mid-1960s Howard was focused on a career in business, and Tatnall was trying to figure out to what career, if any, he should dedicate his time.

By that time, their stepfather Henry Hillman had died. Henry's son, Henry Hillman, Jr., had taken over leadership of The Hillman Company after his father's death and shares of The Hillman Company had been distributed to Hillman family members. In 1965, Henry, Jr., sought to consolidate ownership of The Hillman Company, and approached his relatives with offers to buy out their shares of The Hillman Company.

Howard thought the offer from his step-brother Henry was too low and declined to sell the shares to his step-brother. His mother, Dora, and brother, Tatnall, followed suit and also declined to sell their shares. Howard, Tatnall and Dora eventually reached an arrangement with Henry Hillman, Jr., and remained as owners of stock in The Hillman Company.

The joint action by Howard, Tatnall, and their mother Dora was not coincidental. As of that time, Howard and Tatnall had a deep brotherly bond, having been very close as children. Consistent with this relationship, on August 25, 1968, Howard and Tatnall's mother, Dora Hillman, created an interlocking system of trusts primarily for the benefit of her sons Howard and Tatnall Hillman and their families.¹ The trusts were funded by stock in The Hillman Company.

Dora created the "A-1 Trust" for the benefit of Howard Hillman and his issue, and the "B-1 Trust" for the benefit of Tatnall Hillman and his issue. The "Trust Agreement" provided that the trusts would be administered by the same three "Trustees," two of whom would be Howard and Tatnall Hillman. The Trust Agreement provided the Trustees the power to establish accumulation trusts for the benefit of any beneficiary of the main Trust Agreement. Three days after Dora executed the Trust Agreement for the A-1 and B-1 Trusts, Howard and Tatnall created two additional series of trusts for the benefit of their respective children, the C-series of trusts for the benefit of Howard's children and the D-series of trusts for Tatnall's children. Additional accumulation trusts under the A, B, C, and D-series have been established over the years for the benefit of various beneficiaries.² The value of the A-1 Trust's assets are now conservatively

¹ DX 1 ("Trust Agreement").

² In all, there are 18 such trusts: four in the A-series; six in the B-series; three in the C-series; and five in the D-series. Tr. at 816.

estimated in the neighborhood of \$120 million, and the value of the B-1 Trust is slightly less because of more conservative investing.³

A good deal of the value of the A-1 and B-1 Trusts results from the refusal of Howard, Tatnall, and Dora to go along with Henry, Jr.'s desire to buy them out of The Hillman Company stock. The A-1 and B-1 Trust now each contain around 13% of the stock of The Hillman Company, or around 26% of that Company's stock collectively. Howard considers his leadership in the decision not to sell in 1965 to be the primary reason the Trusts are so well funded, and this likely contributes to his sense that his brother Tatnall should leave the investing decisions to him.⁴

A. A Fast-Forwarded View Of The 1970s And 1980s

Howard and Tatnall reacted to their wealth and economic security differently. After experimenting with teaching and computer programming, Tatnall decided to eschew the pursuit of a paying career. Since 1970, Tatnall has occupied his time with avocations. A devoted skier who now lives in Aspen, Tatnall has volunteered his time patrolling ski mountains in Colorado and as an instructor for disabled and blind skiers. He also continued to serve for several years in the Naval Reserves, and used his wealth to engage in philanthropic activities and non-profit board service.

Howard took a very different tack. After spending nine years at Chemical Bank, Howard decided to concentrate on making his mark as an investor and entrepreneur. One

³ Tr. at 647-48. These figures are approximate. It is unclear whether these estimates incorporate the value of Venhill.

⁴ See, e.g., DX 8 (Henry: "[T]he presumption that I am working to deny any beneficiary long term benefit is contradicted by history. I was the one who 'blew the whistle' on HLH in 1965 (in essence funding this debate) . . .").

way in which he did so was to act as the key Trustee for the Family Trusts. In particular, that role involved Howard in interacting with The Hillman Company. Under the helm of Henry, Jr., The Hillman Company had become an active investor in venture capital and private equity firms as well as high-technology companies.⁵ Apparently, relations with step-brother Henry, Jr. had evolved to the point where the Family Trusts were offered the opportunity to co-invest with The Hillman Company in new deals. Howard would scrutinize these opportunities and select those that he believed had the most promise. Tatnall appears to have played little or no role in this effort, deferring to his brother's greater interest and expertise in business matters.

But that role was not satisfying for Howard. Although wealthy because of the success of The Hillman Company, Howard chafed under the secondary role of his branch of the family. Howard did not want to be dependent on Henry, Jr. Rather, he wanted to use the wealth in the Family Trusts to invest in other opportunities, and thereby reduce their dependence on The Hillman Company.

That desire manifested itself in two key ways. One is non-controversial. That involved Howard developing a relationship with Hambrecht & Quist, a West Coast investment bank that invested in technology start-ups. Eventually, Howard joined the board of that firm, which gave the Family Trusts access to deal flow from a source other than The Hillman Company. The Hambrecht & Quist relationship positioned the Family Trusts to benefit from the exponential growth in the high technology field, as that bank

⁵ The Hillman Company was an early investor in Kleiner Perkins Caufield & Byers, the Silicon Valley powerhouse venture capital firm and Kohlberg Kravis Roberts & Co., a firm critical to the emergence of the private equity industry.

backed many successful technology IPOs, including Apple Computer, Genentech, Adobe Systems, and later Netscape and Amazon.com. But merely selecting deals from two quality investment shops did not satisfy Howard. He wanted to demonstrate more autonomy than that.

And that is where Auto-Trol comes into the story. In 1973, Howard Hillman used cash from the A-1 Trust to buy Auto-Trol from a venture capitalist for \$50,000 and an earn-out. Candidly, the parties did not do a clear job of portraying the evolution of Auto-Trol's business over the quarter-century relevant to this litigation. The most one can confidently say is that Auto-Trol has been engaged in some form of the computer software business for the last several decades, with somewhat of a focus on providing solutions for businesses to manage their operations more efficiently.⁶

It appears that Howard took a hands-on role at Auto-Trol from the get-go, and served as its chairman from 1973 on. His concept for Auto-Trol was grandiose. Although Auto-Trol was a small concern, Howard's vision for it was one he explained by reference to an initiative of a much bigger firm, Xerox. Xerox had created Xerox PARC as a Silicon-Valley based research center. At that center, a number of important technology products were invented, including laser printing, Ethernet, the graphical user interface, and the mouse. Like Xerox's idea, Howard's concept was that Auto-Trol could become a "magnet investment." If Auto-Trol could establish its success with a few products, it could use those products to entice promising technological inventors to come

⁶ In the 1960s, Auto-Trol manufactured oven sensors and in the 1970s was an early entrant in the field of computer aided design.

work for it and develop even more products. These inventive ideas and minds would cross-pollinate, resulting in a sustainably profitable harvest of technology products. As one might imagine, the chronological time at which this vision came to the fore is hard to discern, but that is the basic concept Howard had.

Howard and the Auto-Trol managers appear to have convinced a number of investors that Auto-Trol had a future, including members of the Hillman family. In 1979, Auto-Trol went public. At that time, the A-1 Trust controlled a majority of the shares, but the corporation had raised capital from a number of investors with no relationship to the Hillman Family.

In 1985, Howard Hillman assumed the top managerial positions at Auto-Trol directly, becoming CEO and president. In exchange, he received an annual salary of approximately \$100,000 that remained essentially unchanged until he left Auto-Trol at the end of last year. Howard's ascendancy to CEO of Auto-Trol in early 1985 roughly coincided with another development critical to this case, the formation of Venhill Limited Partnership.

B. The Family Trusts' Form Venhill Near The End Of President Reagan's First Term

By 1984, the Family Trusts were predominantly invested in The Hillman Company as well as investments directed to the Trusts by that Company and Hambrecht & Quist. The A-1 Trust also controlled Auto-Trol, but had only invested a small minority of its overall portfolio.

The Family Trusts, however, did not allow for the nimble action often demanded when investment opportunities arose. The Hillman Company would contact Howard

with a new opportunity, ask him to make an investing decision within 24 to 48 hours, and he would have to get consent from Tatnall and the third Trustee, who was then James Farinholt. This was inefficient, especially because Tatnall was not interested in making investment decisions, and risked the loss of valuable opportunities if Howard could not gain the necessary consents in a timely manner.

To address this problem, the Trustees of the Family Trusts formed Venhill Limited Partnership on October 22, 1984. Venhill's stated purpose was "the acquisition, ownership, investment in, and disposition of personal and/or real property of all kinds, including but not limited to providing capital to corporations, partnerships, and joint ventures" ⁷ The A-1 and B-1 Trusts each took positions as limited partners and contributed 49.5% each of the starting capital. Howard personally contributed 1% of the initial capital and was appointed general partner, charged with "the management and control of the Partnership and its business and affairs." ⁸ Venhill's creation allowed Howard a freer hand to evaluate and invest in the deal flow from The Hillman Company and improve Howard's own efforts to generate a useful private equity deal flow for the trusts as Venhill's limited partners. Like the Trustee positions in the 1968 Trusts, the Venhill general partner was uncompensated. At one point in the mid-1990s, the value of Venhill's portfolio was worth over \$150 million. ⁹

⁷ JX 1 ("Venhill LP Agreement") Art. IV.

⁸ *Id.* § 9.1.

⁹ Tr. at 644-45. Complications stemming from the lack of a ready market for limited partnership interests and a change in the accounting treatment of some assets from cost to fair-market value make this more of an estimate than a value Venhill could have immediately realized in the market. *Id.* at 795-96.

Although Howard had a strong hand at Venhill, it is important to understand that he was not insulated from removal. Under the terms of the Venhill Limited Partnership Agreement, the limited partners could remove Howard as general partner without cause with the only consequence being the obligation to pay him the value of his 1% general partnership interest.¹⁰ Because the limited partners were the A-1 and B-1 Trusts and those Trusts could act through a majority of their Trustees, a vote of 2/3 of the Trustees of those Trusts was sufficient to cause the Trusts to act together to remove Howard.

C. Cousin Joe Steps In To Lend A Hand

In 1987, another Hillman family member enters this story. That year, Joe Hill, the cousin of Howard and Tatnall, replaced James Farinholt as the third Trustee on the A-1 and B-1 Trusts. Hill was a stockbroker in Philadelphia until he retired shortly before trial and he had invested in Auto-Trol shares at Howard's instance. When he took on the role of Trustee of the Trusts, Hill had a good relationship with both his cousins.

D. The Last Decade Of The Twentieth Century: Auto-Trol Tanks And Howard Uses Venhill To Prop It Up

One could say that Auto-Trol was out front in the tech boom of the 1990s, in the sense that it went bust ahead of many other firms in that boom. By 1990, Auto-Trol's annual revenue peaked at \$79.4 million. But its fortunes declined rapidly after that time. By 1994, Auto-Trol's auditors began requiring Howard to provide a letter to Auto-Trol "document[ing] [his] commitment of ongoing financial support to Auto-Trol . . . which

¹⁰ Venhill LP Agreement § 15.2; *Hillman v. Hillman*, 910 A.2d 262 (Del. Ch. 2006).

support will be sufficient to continue operating as a going concern.”¹¹ From 1994 until it “went dark” in 1997, Auto-Trol’s various SEC filings contained this disclaimer:

[T]he Company [is] economically dependent on affiliates of the Company’s President, Chairman of the Board, and majority shareholder . . . [and] will continue to be economically dependent upon financial support from the majority shareholder until it achieves profitable operations. The shareholder has indicated his intent to continue such financial support.¹²

Indeed, Auto-Trol’s auditor required Howard to annually provide a letter documenting his commitment of ongoing financial support “to enable [Auto-Trol] to continue as a going concern through” the end of the year, which he did annually beginning in 1994 for a period ultimately lasting until December 31, 2007.¹³

That Auto-Trol’s strategy of acting as a “magnet” for a variety of technological development efforts failed was not surprising. Other, much better funded efforts along those lines had failed. At trial, Venhill and the plaintiff Trusts proffered the testimony of a respected academic with expertise in the area of venture capital and private equity, Professor Andrew Metrick, then of the Wharton School at the University of Pennsylvania, now of the Yale School of Management. Professor Metrick explained that: “by 1993, many large corporations . . . had given up on [the magnet concept] as being far too expensive and not getting back its returns. But those were large companies with a lot of resources. The notion that a small company . . . would be able to do that is just very, very ambitious.”¹⁴

¹¹ PX 29.

¹² DX 137; *see, e.g.*, PX 93 at 8.

¹³ PX 29; *see* DX 137; PX 34; *see also* PX 31; PX 32; PX 33.

¹⁴ Tr. at 447.

When Auto-Trol began to evidence strong signs of failure, Howard reacted by deepening Venhill's investment in the firm. From 1990 to 1993, Auto-Trol's revenues fell and it was deeply unprofitable. But Howard expressed confidence — as he would continually for the next decade and a half or so — that success was just around the bend for Auto-Trol. Lacking the capacity to obtain outside financing, Auto-Trol, under Howard's dominion, began to look to Venhill as a regular provider of the cash flow it needed to keep from falling into bankruptcy.

Lacking financing, Howard began to fund Auto-Trol through loans from Venhill with a \$500,000 loan on June 11, 1993 at 10% interest.¹⁵ This was followed by another for \$400,000 on June 28, 1993 with similar terms, and yet a third on July 26, 1993 for \$750,000.¹⁶ Howard believed at first that the loans would be temporary. But this pattern of frequent financial support for Auto-Trol would ultimately continue in this fashion, and grow to involve the provision of 186 loans over 12 years.

By the beginning of 1994, Venhill had loaned \$4,650,000 to Auto-Trol, and was continuing to lend it a steady stream of capital. On February 24, 1994, Howard caused \$4 million of the loans from Venhill to Auto-Trol to be converted to shares of Auto-Trol common stock at \$0.75 per share. Without elimination of a substantial amount of debt, Auto-Trol's financial statements would have shown negative shareholder equity. The health of Auto-Trol's balance sheet was important because its better-financed competitors pointed customers to Auto-Trol's weak financial statements as a reason not to purchase

¹⁵ JX-52 at 1.

¹⁶ *Id.*

its software. Throughout 1994, Venhill made an additional \$4.6 million in loans to Auto-Trol, receiving a repayment of only \$200,000, and converted another \$6,413,986 of loans into equity in February and December.¹⁷

Although they knew that Auto-Trol was Howard's passion and that the transactions between Auto-Trol and Venhill involved Howard acting on both sides of the transactions, Tatnall and Joe Hill did not initially object to these infusions of support. As of that time, Howard had been successful as Venhill's general partner in managing its investments and Auto-Trol had been unprofitable for only three years. But by 1994, Tatnall and Hill began to express concern over Howard's deepening support of Auto-Trol with Venhill funds.

In 1994, Joe travelled to Colorado to visit Auto-Trol and surveyed the company "to find out what was going on and find out if there's any collateral backing this sizable amount of investment."¹⁸ Howard welcomed the visit, and gave Joe access to Auto-Trol's management and facility.¹⁹ Joe concluded after that brief visit that he was "somewhat satisfied, but a little skeptical."²⁰

Around the same time, Howard began to express a desire to separate his family's interests from those of Tatnall's family, by having a separate set of Trustees for each side of the family. To that end, Howard proposed that he resign from his Trustee positions in

¹⁷ JX 52.

¹⁸ Tr. at 585.

¹⁹ *Id.* at 317-19; *id.* at 585 (Hill: "So I came back at that point somewhat satisfied, but a little skeptical, hoping that things would turn quickly.").

²⁰ *Id.* at 585.

the Tatnall Hillman trusts — the B-series and the D-series — and that Tatnall and Joe resign from their Trusteeship of trusts benefiting him — the A-series and the C-series.

Joe refused to resign, citing that he had “a responsibility to be sure that someone with a knowledge of fiduciary duties follow me so that all is in good hands.”²¹ Tatnall similarly refused. Their principal concern was that if they resigned from the A and C-series and Howard remained, Howard would squander the funds held in trust for his children.²² They also feared legal exposure to the other beneficiaries of the Trusts.

1995 came and went without any satisfactory resolution of the simmering disagreements among the Trustees. By year-end, Venhill had invested almost \$20 million in total in Auto-Trol, and Auto-Trol now comprised almost 20% of Venhill’s portfolio.²³ For its part, Auto-Trol’s performance continued to be poor, as the company experienced declining revenues and persistent losses.

Howard proceeded without hesitation to pour Venhill funds into Auto-Trol. Joe Hill and Tatnall knew he was doing it and expressed discontent. But they did not remove him as general partner of Venhill. Joe Hill began emphasizing the conflict situation that Howard was in and at one point threatened to have the Auto-Trol shares owned by the C-1 Trust voted against Howard’s re-election at the Auto-Trol annual meeting in 1996.

²¹ DX 4.

²² See DX 8 (letter from Howard Hillman to Tatnall Hillman, dated Sept. 10, 1995) (“From what I comprehend, your refusal to resign unless I resign from my own trusts is prompted by the belief that my children need ‘protection.’ What in your opinion is needed and when is there enough?”); see also DX 11 at 2.

²³ PX 114 (“Baines Report”) at Ex. 3.

But Joe did not act on that threat when Howard furiously objected to such a public vote of no confidence in him and Auto-Trol. At that meeting, Auto-Trol actually engaged in a ten to one reverse stock split that enabled it to convert additional Venhill debt to equity. Again, the purpose of that conversion was simple: without doing so, Auto-Trol's balance sheet would have demonstrated that it was insolvent. In the wake of that incident, Howard tried to hasten the disentanglement of the interlocking trusts by resigning from the D-1 series of trusts on February 9, 1996.²⁴ Tatnall and Hill did not follow suit, and they along with Howard remained the three Trustees for the A, B, and D-series of trusts.

Inspired mostly by a desire to preserve a fragile family relationship, Tatnall and Joe continued to tolerate further investments in Auto-Trol but in an increasingly questioning and begrudging manner. By 1996, a "heavy deal flow and large expenditures" had "virtually eliminated" Venhill's liquidity, and Howard requested additional funds from the Trustees from the A-1 and B-1 Trusts as well as suggested loans from other trusts.²⁵ The enormous outflow of cash to Auto-Trol without any reasonable rate of return was the major contributor to this problem. Instead of funding Venhill from contributed capital as they had before, the Trusts began to use loans to Venhill as the method of financing. The A-1 and B-1 Trusts each made their last capital contribution to Venhill on April 12, 1995. In May and November of 1996, the A-1 and

²⁴ JX 8.

²⁵ DX 13.

B-1 Trusts began to make a series of loans to Venhill.²⁶ On October 18, 1996, the Trustees met in Denver and decided to fund Venhill with loan financing through December of 1997, with \$42 million in capital split between the A-1 and B-1 Trusts.²⁷

Auto-Trol showed some fleeting signs of profitability in its fourth fiscal quarter of 1997, with a profit of \$117,000, which Howard made sure to convey to Tatnall. He cautioned that, “[w]hile [Auto-Trol] broke the pattern, [he did] not expect to be consistently in the black (unfortunately) from [then] on”²⁸ That was a bit of an understatement.

1997 was the last year that Auto-Trol’s shares were listed on a public exchange, as the NASDAQ pulled its listing because of Auto-Trol’s poor financial condition. And, despite its profitable last quarter of 1997, by the next year, Auto-Trol had rapidly oriented itself back to its favorite red trail and showed no prospect of changing course.

By the end of the Clinton years, the relationship between Howard, on the one hand, and Tatnall and Joe, on the other, had deteriorated. The parties lawyered up, and Howard’s communications with Joe were contemptuous and confrontational.

Howard continued to express a putative desire for separation of his affairs from those of his brother. Howard asked the other Trustees if the B-1 Trust wished to withdraw from Venhill. But, of course, Howard was not proposing any plan to make the B-1 Trust whole for the losses it and Venhill had suffered because of the huge infusions into Venhill. Because Venhill had not had a liquidity event from its non-Auto-Trol

²⁶ DX 64 at 204, 219; DX 65 at 269, 274; Tr. at 771, 772.

²⁷ DX 14; *see also* DX 19.

²⁸ JX 16.

investments for some time and because Venhill's portfolio had become dominated by the losing Auto-Trol investment, it did not have the funds to pay off the loans from the B-1 Trust, much less to fully buy out its stake in Venhill.²⁹

Although Joe and Tatnall continued to procrastinate on removing Howard as Venhill's general partner, they began to restrict his discretion in other ways. On September 4, 1998, the Trustees instituted several limitations on Howard at the trust level, by tightening the previously loose style of trust administration:

You have put A-1 cash into Venhill as a loan recently . . . without either one of your fellow Trustees being informed. We realize that this is a style that has had our approval in the past but the time has come due to the visible shortage of cash to clarify the Venhill funding and investment commitments policies.³⁰

Tatnall and Joe expressed their desire for the Trustees to obtain a 2/3 vote in favor of any new investments by Venhill requiring additional trust investment, "ideally" the approval of 2/3 of the Trustees for any A or B-series Trust expenditure in excess of \$50,000 and an absolute prohibition on Howard investing C or D-series funds.³¹ They also commented on Auto-Trol: "We were told that Auto-Trol would be cash break-even by the end of 1997. Since then Auto-Trol has cancelled its major research project and cut back in a major way. The remaining products do not support the expense and *the end of the cash drain does not seem in sight.*"³² Tatnall echoed this sentiment in an email written to Howard on September 7, 1998: "If a loan is made to Venhill, will it disappear

²⁹ DX 17.

³⁰ DX 19.

³¹ *Id.*

³² *Id.*

into the black hole of Auto-Trol?”³³ By that date, Venhill had already invested \$39,475,000 in Auto-Trol.

At trial, Tatnall testified that he believed in September of 1998 that Howard was breaching his fiduciary duties to the A-1 and B-1 Trusts by loaning Venhill funds to Auto-Trol.³⁴ Nevertheless, Tatnall and Joe agreed to live up to their previous commitment to provide “Auto-Trol support . . . through December 31, 1998.”³⁵

On October 30, 1998, Joe and Tatnall went to Denver to convince Howard to discontinue Venhill’s support of Auto-Trol. During those two days of meetings, Joe Hill demanded that Howard stop funding Auto-Trol and initially told him the Trustees would not support Venhill past December of 1998.³⁶ Howard asked for more money for Venhill from the A-1 and B-1 Trusts that could be used to support Auto-Trol.³⁷ At the end of the meeting, Joe and Tatnall were again worn down by Howard’s adamancy and influenced by their own desire to avoid an open family conflagration. They therefore reluctantly agreed to fund Venhill from the A-1 and B-1 Trusts so that Venhill could fund Auto-Trol for another year even though Howard himself had admitted not knowing when the loans would be repaid to the Trusts.³⁸

³³ DX 20.

³⁴ Tr. at 692.

³⁵ DX 20.

³⁶ Tr. at 696.

³⁷ *Id.* at 696-97.

³⁸ *Id.*

E. A New Century Begins, But The Hillman Family's Commitment
To Inertial Behavior Persists

By the Millennium, brotherly love was almost entirely depleted, and Howard and Joe were openly disdainful of each other. But time marched on with little change. Although Tatnall and Joe prevented the A-1 and B-1 Trusts from making further loans to Venhill, Howard continued to use his discretion as Venhill's general partner to fund Auto-Trol using its remaining capital. While the parties dickered at a slow pace over a global resolution of their differences, Auto-Trol continued to founder, losing money and needing Venhill's support to pay its bills. In July 2002, Auto-Trol went private but not in a happy premium-paying deal sponsored by KKR or Blackstone. Rather, its non-Hillman stockholders were cashed out for a pittance of twenty cents per share.³⁹

Between 1994 and the 2002 going private transaction, Howard had caused Venhill to convert over \$50 million of Auto-Trol debt into equity. This had resulted in Venhill owning over 95% of Auto-Trol and Hillman affiliates owning 99.7% of Auto-Trol before the going private transaction, and 100% after.⁴⁰ As a private company, Howard no longer needed to convert debt to equity, and the last such conversion had taken place in April of 2001. By June 24, 2002, Venhill had invested \$63,800,000 in Auto-Trol, but the bulk of which Howard had converted into equity. On January 1, 2003, Howard caused

³⁹ JX 47 at 5.

⁴⁰ *Id.*

Auto-Trol to reissue a note consolidating the remaining \$15,950,000 of debt into a single note.⁴¹

During 2003, things came to a bit of a head when accounts for 13 Hillman trusts were filed in the latter part of 2003 in the Orphans' Court of Westmoreland County, Pennsylvania. In connection with the accounting litigation, Hempstead & Co. prepared an appraisal of Auto-Trol (the "Hempstead Valuation") that valued Auto-Trol's equity at \$359,000 as of October 10, 2003, and rounded that figure to approximately \$600,000 based on the value of operating loss carry-forwards for tax purposes, \$0.01 per share.⁴² Howard, of all people, disputed this valuation and contended that it *overstated* the value of Auto-Trol. He offered Tatnall and Joe a dollar — yes, one picture of George Washington — for the equity of Auto-Trol.

Despite Howard's own position that Auto-Trol was essentially worthless, he kept using Venhill funds to prop it up. Even worse, Howard caused Venhill to transfer funds to Auto-Trol, which he then used to make payments to himself. Thus, on March 8, 2004, Howard had \$700,000 transferred from Venhill to Auto-Trol. Howard used these funds to repay the principal and interest of a \$200,000 loan to himself and a \$450,000 loan made to Auto-Trol by a trust that he had formed for he and his children, called the Vineyard Trust. During 2003 and 2004, Howard caused Venhill to make a total of \$12,950,000 million in loans to Auto-Trol at the short-term Applicable Federal Rate

⁴¹ Although neither party has described the terms of that note, consistent with Howard's practice throughout that period, it was likely at the short-term AFR rate and matured in less than three years. *See* PX 116 Ex. 4. Howard began making loans at the AFR rate, instead of the previously used rate of 10% in July of 2002.

⁴² PX 12 at 29; Tr. at 146-47.

("AFR"). This interest rate was well below any rate that could be found in commercial lending and during the relevant time period it reached as low as 1.21%. Indeed, if the interest rate had been any lower, Venhill would have been required to pay taxes on interest income, even if the loans were never repaid.

F. Suspecting That Tatnall Would Finally Remove Howard As General Partner Of Venhill, Howard Secretly Places Auto-Trol Out Of Venhill's Reach

On January 22, 2005, the Westmoreland County Court convened a conciliation conference in the accounting litigation on January 22, 2005. After the conciliation conference, Howard suspected that he might be removed as Venhill's general partner and began to make preparations for that contingency.

On January 28, 2005, Howard engaged in a series of transactions designed to protect Auto-Trol in the event that he was replaced. For one, he loaned Auto-Trol another \$2 million from Venhill to build in a cushion for the year's operating expenses. Simultaneously, he reissued a note for the balance of all the outstanding loans due to Venhill from Auto-Trol, which had maximum maturity dates of three years, into a single note for the principal amount of loans that Venhill had made to Auto-Trol since 2000 — some \$31,520,000. The note would not come due until January 28, 2020 and would only require payment of interest at the then-long-term annual AFR rate of 4.76% "from time to time."⁴³

Howard also executed a strategy that would prevent a subsequent general partner from gaining control of Auto-Trol through Venhill's ownership of Auto-Trol stock.

⁴³ PX 85.

Howard created HMC Enterprises, LLC with Howard as the sole manager and Venhill as the sole member, and transferred all of Venhill's Auto-Trol stock to HMC.⁴⁴ The HMC Operating Agreement provided that Venhill "shall not have any right or power to take part in the management or control of the LLC or its business or affairs."⁴⁵ The Operating Agreement also provided that Howard would remain in office until death, resignation or removal by Venhill, provided there was an "issuance of a non-appealable judicial determination by a court of competent jurisdiction expressly stating that the Manager acted with gross negligence or willful misconduct in performance of his duties as [HMC's] Manager."⁴⁶ Additionally, Venhill could not assign or pledge any part of its membership interest without prior written consent from Howard, which he could deny in his sole discretion.⁴⁷ Howard did not inform Tatnall and Joe of the HMC transaction and they would not discover it until ten months later.⁴⁸

G. Tatnall And Joe Finally Remove Howard As General Partner of Venhill

An hour before a telephonic Trustee meeting on July 26, 2005, Howard received an email attaching a consent form for the removal of the Venhill general partner and also attaching William Stallkamp's curriculum vitae.⁴⁹ Believing that his removal was imminent, Howard absented himself from the meeting and began taking actions at

⁴⁴ PX 4; PX 87.

⁴⁵ PX 87 § 9(a).

⁴⁶ *Id.* On Howard's death, his estate would spring into the Manager Position until resignation or an identical judicial determination. *Id.*

⁴⁷ PX 87 § 11.

⁴⁸ Tr. at 169, 554-55.

⁴⁹ *See* JX 53; PX 90.

Venhill before he received formal notice of his removal.⁵⁰ He caused Venhill to loan yet another \$2 million for Auto-Trol's future needs, paid his personal lawyers \$56,254 for legal services in connection with the Westmoreland County litigation, and reimbursed himself for \$300,816 in out-of-pocket expenses and legal fees he had personally paid his lawyers in connection with that litigation.⁵¹ Joe and Tatnall continued the meeting, removed Howard as Venhill's general partner, and installed William Stallkamp in his place.

H. The Family Squabble Results In Litigation In This Court

On August 9, 2005, Howard attempted to convert his 1% interest in Venhill into a limited partnership interest, and was denied, leading to a previous lawsuit in this court.⁵² On December 30, 2005, plaintiffs Venhill, the A-1 Trust, and the B-1 Trust filed this action, in which they sued Howard Hillman and HMC for an accounting, for alleged breaches of his fiduciary duties of care and loyalty to Venhill, and for conversion of Venhill's Auto-Trol stock.⁵³

I. Howard Continues To Support Auto-Trol

After Howard was removed as Venhill's general partner, Auto-Trol continued to need inflows of capital to pay its mounting debts. The HMC transaction insulated Auto-

⁵⁰ Tr. at 177; JX 79 at 2.

⁵¹ Pre-Trial Order; Tr. at 177, 178, 818-20.

⁵² See *Hillman v. Hillman*, 910 A.2d at 262 (holding that Venhill's Limited Partnership agreement did not allow Howard to convert his interest, but that he was entitled to the fair value of his partnership interest).

⁵³ After that suit concluded and before trial in this case, the parties agreed that Venhill would offset Howard's 1% economic interest in Venhill by the amount of personal legal fees that Howard reimbursed himself. Venhill Opening Post-Trial Brief at 2.

Trol from Venhill's collection of outstanding debt or exercise of its voting rights, but it did not allow Howard to continue funding Auto-Trol with Venhill money. Howard attempted to secure commercial financing for Auto-Trol, but unsurprisingly could not find a third-party willing to provide it.

Howard therefore turned to other trusts that he controlled to pay Auto-Trol's bills. By May of 2006, the C-1 Trust for the benefit of Howard's children had replaced Tatnall and Hill as Trustees with Elise Hillman Green, Howard's daughter, and Irene Riebe, Howard's long-time personal assistant.⁵⁴ Howard's personal friend, Theodore Rupert, remained as the third Trustee.

Over 2006 and 2007, with Tatnall and Hill no longer administering the C-1 Trust, the C-1 Trust loaned Auto-Trol \$2.91 million over 2006 and 2007 at interest rates of 8.25% to 8.75%, not the AFR he used when putting Venhill's funds at stake. These loans were personally guaranteed by Howard.⁵⁵ The Vineyard Trust of which Howard was the sole Trustee and, along with his children, the sole beneficiary, loaned \$815,000 to Auto-Trol over the same period at interest rates of 7.5% and 7.75%.⁵⁶

When these sources of financing were nearly exhausted, Howard sought Auto-Trol board approval to request a \$6 million loan from Venhill in late February 2007 that he

⁵⁴ Tr. at 183-84. Neither party has explained when Elise Hillman Green and Irene Riebe replaced Tatnall and Hill as trustees for the C-1 Trust. Based on certain correspondence in the record, Tatnall and Hill occupied roles as trustees of C-1 as late as the autumn of 2003.

⁵⁵ PX 155; PX 197; Tr. at 184; *e.g.*, PX 99.

⁵⁶ PX 197; Tr. at 184; *e.g.*, PX 98. Howard purchased these loans personally on April 4, 2007. PX 135; Tr. at 185.

projected would keep Auto-Trol operating for the next year.⁵⁷ Without additional financing, Auto-Trol could not make payroll.⁵⁸ Auto-Trol's two outside directors did not approve Howard's request for a unanimous board consent that would enable Howard to request a further loan from Venhill. Instead, they resigned, citing concerns about the commercial reasonableness of the loan, and what they perceived as a growing detachment from Auto-Trol's operations and Howard.⁵⁹ The next day, Howard emailed a term sheet to Stallkamp requesting a \$6 million loan.⁶⁰ Stallkamp refused.

Faced with no other means of supporting Auto-Trol, Howard sought to force Venhill to provide it. On April 27, 2007, Howard solicited Stallkamp's participation in a Subscription Offering for additional Auto-Trol shares offered to current stockholders at a 50 to 1 ratio.⁶¹ Venhill's portion of the offering was to be around \$2.5 million and a failure on its part to participate would severely dilute Venhill's ownership. On May 4, 2007, Venhill filed a motion for a temporary restraining order in this court to enjoin the Subscription Offering. That motion was ultimately resolved by a stipulation between the parties on May 11 in which Howard agreed not to conduct the Subscription Offering in return for allowing him to personally loan funds to Auto-Trol secured by Auto-Trol's real estate at commercially reasonable rates.⁶² The parties agreed that "[a]ll preferences or priorities created or implied by the Security Interest, [its] validity and enforceability . . .

⁵⁷ PX 107; *see also* PX 106.

⁵⁸ PX 106.

⁵⁹ PX 107.

⁶⁰ PX 106; Tr. at 556.

⁶¹ PX 132; Tr. at 556-57.

⁶² PX 138 ¶¶ 2, 3(a) (Stipulation and Order dated May 11, 2007).

and Howard B. Hillman's entitlement to repayment for any consideration he provides to Auto-Trol after May 11, 2007 shall be subject to the final resolution of [this lawsuit]."⁶³

A four-day trial in this case was held over October 29 to November 2, 2007.

Throughout trial, Howard took the position that his transfer of Venhill's Auto-Trol stock to HMC was proper and defended himself against the claim that the transfer was a breach of duty. A month after trial, Howard reversed course and transferred all the Auto-Trol stock owned by HMC back to Venhill and dissolved HMC.⁶⁴ He also resigned from all employment and board positions at Auto-Trol effective on December 31, 2007.⁶⁵

III. The Major Claims In This Case

The essence of this case is simple to grasp. The plaintiffs are Venhill, which was authorized to bring this action by Howard's successor, Stallkamp, and the A-1 and B-1 Trusts. They argue that Howard breached his fiduciary duties of loyalty and care to them by causing Venhill to engage in a series of imprudent, unfair, and irrational investments into and transactions involving Auto-Trol.

As a remedy, they seek to hold Howard liable for the losses suffered by Venhill, not only for the loss of the principal invested by Venhill, but also for the loss of profits that would have been made had the funds been prudently invested along the lines of Venhill's other investing activity.

On the eve of trial, the plaintiffs finally made an important concession. Originally, they sought to hold Howard responsible for all the investment decisions involving Auto-

⁶³ PX 138 ¶ 3(b).

⁶⁴ Letter from David E. Wilks to Vice Chancellor Leo E. Strine, Jr., Dec. 4, 2007.

⁶⁵ *Id.*

Trol regardless of when they occurred. Thus, they sought damages for decisions made by Howard dating back to the early months of the Clinton Administration.

Recognizing that Howard's proclivity to invest Venhill funds in Auto-Trol was rather well known to Tatnall and Joe, the plaintiffs belatedly limited their request for relief to those transactions entered into by Howard on or after December 30, 2002, the period within three years of the filing of their claims. By this means, the plaintiffs ensured that they only sought damages for claims that were not time-barred.

This concession was helpful in narrowing the issues, but did not obviate the need for the court to consider the 35-year history of the Trusts' involvement with Auto-Trol. Lest the big picture be lost in the minutia, a basic summary of the overall effect on Venhill of the Auto-Trol investment decisions made by Howard usefully precedes a consideration of the legal issues that I must decide.

For the sake of clarity, I frame this summary in terms of the periods before which any claims would be stale and the period after which claims remain viable.

A. Venhill's Investments Into Auto-Trol From 1993 To Late 2002

During the period from June 11, 1993 until December 30, 2002, Venhill loaned approximately \$68 million to Auto-Trol. These loans were first issued at an interest rate of 10% until after June 28, 2002, when Howard caused new loans to be issued at the short-term AFR. Interest payments were made every year except 1995 totaling \$3,520,425. Over \$50 million of those loans were re-characterized from debt to equity in 21 transactions from 1994 to 2001. In the second half of 2000, Venhill directly invested \$2.5 million in Auto-Trol equity. By these transactions and the going private merger in

2002, Venhill came to own more than 95% of the shares outstanding in Auto-Trol. Howard Hillman or entities affiliated with him own the balance.

At the end of Howard's first year of investing Venhill funds in Auto-Trol, Auto-Trol investments constituted slightly less than 10% of Venhill's portfolio of assets. That concentration rose steadily, passing 20% in 1996, and 30% in 1998. By the end of 2002, nearly 45% of Venhill's portfolio was tied up in Auto-Trol. In comparison, no other asset held by Venhill ever exceeded 20% of its portfolio, and in most years no other asset exceeded 10% of its portfolio.

During this same period, Auto-Trol's fortunes rose and rapidly sank. From its listing on the NASDAQ in 1979 and revenue height of nearly \$80 million in 1990, in 2002 Auto-Trol was delisted, insolvent (or nearly so), and had annual revenues that were less than a tenth of the 1990 high. It had been on life-support with infusions of capital from Venhill averaging more than once a month for nearly a decade with only one profitable quarter in thirty-eight. The A-1 Trust's \$50,000 investment in Auto-Trol, which had grown to a market value of roughly \$100 million at one time, would shortly be valued by Howard himself as less valuable than the cost of a Happy Meal.

B. The Remaining Remedies Sought Against Howard Hillman

Venhill and the plaintiff Trusts now ask this court for several remedies for Howard's alleged breaches of fiduciary duty from December 30, 2002 until the Trusts removed Howard on July 26, 2005. They seek rescission of the January 28, 2005 promissory note for \$31,520,000 that, among other things, consolidated the debt at that time into a single note that is not due until 2020. Provided the court unwinds that note,

they seek damages for 52 new loans Venhill made to Auto-Trol in the aggregate principal amount of \$17,870,000. The plaintiffs also believe that Venhill is entitled to damages for Venhill's reissuance of a \$15,950,000 note on January 1, 2003 that refinanced debt that Auto-Trol incurred to Venhill over the entire time-frame dating back to 1993, including the principal. In accordance with the terms of the May 11, 2007 stipulation that allowed Howard to directly invest up to \$6 million in Auto-Trol,⁶⁶ the plaintiffs want any security interest created in Auto-Trol's real estate to be cancelled. In addition, the plaintiffs argue that they are entitled to attorney's fees for prosecuting this action in light of what they style as bad faith on Howard's part in the underlying conduct. Finally, the plaintiffs seek an award of post-judgment interest.

IV. Legal Analysis

A. The Lack Of A Coherent Strategic Plan For Auto-Trol And The Related Battle Of Experts

Before deciding the legal claims of the parties, it is useful to address the state of the record regarding Auto-Trol and the expert testimony regarding the propriety of Howard's decisions to keep investing in Auto-Trol. These are related subjects, as will soon become clear.

The first issue can be disposed of briefly. At trial and in his briefs, Howard has entirely failed to articulate a coherent business strategy for Auto-Trol that would result in it becoming a healthy, solvent company, capable of paying off its creditors and going forward on a profitable basis. From the record, one can conclude that Auto-Trol has

⁶⁶ PX 138 ¶ 3(b).

developed some useful software, which allows businesses to track production and service delivery processes, and produce technical illustrations of complex designs. It has some big name customers, but decidedly small change revenues.

As important, there is no evidence that Auto-Trol ever engaged in a rational business planning process during the last 15 years. That is, there is no reason to believe that Auto-Trol has ever prepared strategic plans that articulated financial goals, product developments, and sales benchmarks in relationship to some rational time horizon. When did Auto-Trol intend to turn the red ink into black ink? How?

The record is devoid of any indication of planning of this type. As a result, the kind of showing that private equity and venture capital investors would have expected from a company seeking funding is not one that Auto-Trol ever made, and there is no basis for me to believe could have made. Howard poured funds into Auto-Trol without asking himself and his management team to do the sort of disciplined work that a third-party investor would have demanded as a pre-condition to considering the provision of funding.

This issue relates to the expert testimony presented. At trial, each side presented an expert about the soundness of Howard's decision to keep putting funds into Auto-Trol. Howard attacks the admissibility of the testimony of the plaintiffs' expert, Professor Andrew Metrick, then of the Wharton School, now of the Yale School of Management. Professor Metrick provided testimony about the prudence of Howard's investment decisions and whether they comported with the approach taken by private equity and venture capital investors.

Howard complains that Professor Metrick's testimony is unreliable and should be excluded. In particular, he complains that Professor Metrick did not examine the particular circumstances of Venhill and Auto-Trol, but considered general market circumstances that typically involved transactions far larger than those between Venhill and Auto-Trol. I reject this attack.

Professor Metrick is the author of a textbook entitled *Venture Capital and the Finance of Innovation*, and has published and taught in areas directly relevant to the issues in dispute in this case. He is well qualified to give testimony about the standards used by investors in making the types of equity investments and high-risk loans Venhill was making into Auto-Trol. That Howard undertook to have Venhill, which was a vehicle for investing his family's wealth, make investments that were different in size, scope, and character from those a disinterested investor might make does not make Professor Metrick's testimony irrelevant. Rather, that reality is itself a factor bearing on the prudence of Howard's decision-making process.

I will therefore admit Professor Metrick's testimony. That testimony was persuasive and can be summarized as follows:

- As of the year 1995, Auto-Trol was well past being considered an attractive or even suitable investment for a prudent private equity investor. Being virtually insolvent, having already converted over \$50 million in loans from Venhill into equity to avoid bankruptcy, and having no growth prospects, in 2003, Auto-Trol was not a company to which a rational investor would have entrusted further funds;
- The terms on which Auto-Trol loaned money to Venhill were grossly disparate from those that Auto-Trol would have gotten in the market. As to that, Metrick believed no third party would have funded Auto-Trol at all. If one had, it would have demanded terms far different than

Howard extracted. Instead of a loan on terms better than a AAA borrower could have gotten, Auto-Trol would only have had funds at extremely high interest rates, with an equity option for the lender, and corporate governance provisions that enabled it to take control;

- The sheer number of loans Venhill made to Auto-Trol reflected a lack of discipline uncharacteristic of private equity and venture capital investors. These investors would typically never make more than four or five carefully thought out rounds of financing over the life of a company. By contrast, Howard made 14 loans a year or so to Auto-Trol;
- Private equity and venture capital investors always seek to know when they will achieve liquidity. Auto-Trol presented no reasonable prospect for exit by Venhill, as it had no plans for growth to a level where it could go public again or be in shape to be sold to another industry player;
- Howard’s “magnet investing strategy” is one that rational investors would eschew. According to Metrick, private equity and venture capital investors achieve success by making a number of risky bets, with a minority (20-30%) paying off in a public IPO exit and a still smaller number hitting it really big. If Venhill had really wanted to attract additional investments, it should have followed that strategy and made a number of investments. Instead, by concentrating so much of its capital into Auto-Trol, Venhill minimized its chances for success;
- Relatedly, Howard imprudently concentrated Venhill’s portfolio in Auto-Trol. By 1995, Auto-Trol represented 19% of Venhill’s portfolio. Since 2003, it has exceeded 50%. According to Metrick, this type of concentration is unheard of in the private equity industry, where most funds limit any one investment to no more than 20% of the fund’s portfolio.

On all these points, I found Metrick’s testimony reasonable and understated.

Howard’s investment decisions were grossly disparate from any that a rational investor would have made, and Metrick calmly pointed out why by reference to common industry practices.

Moreover, Howard's complaint that Metrick did not examine Auto-Trol closely does not affect my view. If Auto-Trol had a persuasive business plan, no doubt Metrick would have considered it. But then so would I.

The reality is that no coherent articulation of Auto-Trol's strategy during the relevant period exists. One cannot fault Metrick for that. Rather, the absence of any blue-print for turning Auto-Trol from an insolvent company with flagging revenues into a profitable concern that could pay off its debtors and make a return to its equity holders provides support for Metrick's fundamental position, which is that no rational investor would have entrusted further capital to Auto-Trol in this century.

To support his contrary view, Howard presented the testimony of Steven Kursh, who had spent years in the software field and is now essentially a clinical professor (a so-called Executive Professor) at Northeastern University. Kursh weakly defended Howard's investments into Auto-Trol, mainly by pointing out that the software industry was risky, but that many such firms had been sold for a profit. Because Auto-Trol had some big name customers — albeit ones whose cumulative payments resulted in total revenues for Auto-Trol of only \$6,463,000 in 2002 — Kursh opined that a “private equity investor during the relevant period from 1993 to the time of my research could have considered Auto-Trol as a potentially viable company that could provide positive financial returns to investors.”⁶⁷ That said, Kursh admitted:

One of the cardinal rules in investment management (and business financial management in general) is never to make decisions on sunk costs. While the Venhill investments in Auto-trol are relatively large when

⁶⁷ PX 135 (“Kursh Report”) at 10.

considered in totality, my research found that the investments made by Mr. Howard Hillman in Auto-trol, particularly investments made beginning in the late 1990s, were made at times when Auto-trol could have provided positive financial returns (on those specific investments) going forward.⁶⁸

The key for Kursh is that despite Auto-Trol's high debt and mounting red ink, someone could have come along and decided to buy off the debtors and pay the equity holders money for their stock to get at Auto-Trol's technology and customers. But his testimony was not rooted in any financial or business reality.

From 1993 to 2005 is 12 years! During that time, Auto-Trol was insolvent. Its revenues had plummeted and stagnated. Contrary to what any rational controller would have done, Venhill did not push for a liquidity event because Howard wanted to keep running Auto-Trol. Thus, the very premise that Kursh relied upon — that it might have made sense to invest in Auto-Trol to dress it up for sale — was not one that Howard was even pursuing.

As important, Kursh's testimony was entirely abstract. He had no opinion that Auto-Trol had or was developing software of such potential utility as to generate a potential for its emergence from the ashes. Nor did he consider what its lengthy record of failure suggested about its future prospects.

And Kursh could not even stomach giving Howard a complete endorsement. He explicitly refused to opine that several transactions engaged in by Howard were entirely fair, including conversions of debt owed to Venhill into Auto-Trol equity. Even more than that, Kursh's opinion that the loans Howard was causing Venhill to make to Auto-

⁶⁸ Kursh Report at 10.

Trol from December 30, 2002 onward were on fair terms is without any logical basis. For one thing, he attributed the interest rate to Venhill's accountant, rather than Howard.⁶⁹ But it was Howard's job to make investments and the idea that Howard's personally chosen accountant, rather than Howard, set the terms provides no evidence of fairness. Howard's own trial testimony contradicts Kursh's interpretation and clarifies that the true purpose of his accountant's suggestion that the interest rate be changed from 10% to the AFR was entirely unrelated to the merits of the investment. Instead, that rate was the absolute lowest Venhill could have earned without creating tax liabilities for imputed interest income it would never earn.⁷⁰ This would have left fewer dollars to invest in Auto-Trol. Moreover, Kursh's report in regard to the loan terms is premised on his assumption that the plaintiffs "understood that Auto-Trol had little or no value based on the findings of the Hempstead valuation dated October 10, 2003 if not sooner."⁷¹

But, if it was true that Auto-Trol had no value as of December 30, 2002, and Kursh has provided no basis to doubt that, then Kursh's testimony is entirely nonsensical. If there was no plausible basis to believe that further infusions into Auto-Trol would provide a commercially reasonable chance that Auto-Trol could attain a level of success sufficient to pay off its existing indebtedness to Venhill, and Kursh's own report suggests there was none, then by his own logic about the irrelevance of sunk costs, it was utterly irrational for Venhill to act as a lender by providing an insolvent borrower with rates of

⁶⁹ Kursh Report at 42; Tr. at 902.

⁷⁰ Tr. at 89-90.

⁷¹ Kursh Report at 42.

interest better than could be achieved by a borrower with a AAA credit rating.⁷² Indeed, at trial, Kursh admitted that “based on the specific terms that were there, [he] would not have made those loans”⁷³ and “[i]n [his] opinion, [Auto-Trol] could not have received financing from a completely independent third party at the terms [it did].”⁷⁴ In other words, a disinterested fiduciary, acting solely in the interests of Venhill would not have made loans on those terms.

In summary, in this battle of the experts, one side came out decisively on top. Professor Metrick gave balanced testimony, well grounded in common practices among relevant investment communities, that identified a multitude of reasons why Howard’s investments into Auto-Trol during the relevant period were imprudent, unfair to Venhill, and inconsistent with the behavior of a rational investor.

B. The Standard Of Review Relevant To The Determination Of Whether Howard Is Liable For Damages To Venhill And Its Limited Partners

The plaintiffs and Howard manage to both disagree and agree about the procedural standard that applies to evaluate the plaintiffs’ claim that Howard breached his fiduciary duties by investing Venhill funds in Auto-Trol. The point of agreement is that both accept the idea that the investment decisions regarding Auto-Trol that were made by Howard are subject to the entire fairness standard. The reason for that is obvious:

⁷² Metrick testified without rebuttal from Kursh that even if Auto-Trol could have somehow obtained a loan, it would have paid high-yield rates that were, at times, 20% higher than the interest rate it was paying Venhill. *See* PX 181; PX 116 Exs. 3, 4; Tr. at 428-29.

⁷³ Tr. at 952.

⁷⁴ Tr. at 941.

Howard was on both sides of the transaction, acting as Venhill's general partner and as Auto-Trol's chairman, CEO, and president.⁷⁵

From there, things get murky. Howard complicates the analysis with two arguments, which I will address now in turn. First, Howard contends that because his fellow Trustees Joe and Tatnall had been aware that he was going to continue pouring funds into Auto-Trol from 1995 onward, their failure to take action as Trustees to remove him had the effect of ratifying or acquiescing in his decisions, regardless of whether he informed them in advance of the specific terms on which those investments were made.

As I understand this argument, it is premised on the assumption that if stockholders with voting power object to a particular business strategy of a fiduciary and fail to use that voting power to remove the fiduciary, those stockholders are deemed, by their failure to exercise their power of removal, to have assented to the strategy and are barred from contending that the strategy's implementation was a breach of fiduciary duty. Stated summarily, this rule would impose on stockholders a duty to remove a fiduciary who was bent on pursuing what the stockholders believed to be an imprudent strategy because if they do not do that, the fiduciary's actions will be immunized from the ordinary scrutiny of equity.

⁷⁵ E.g., *In re Boston Celtics Limited P'ship S'holders Litig.*, 1999 WL 641902, *4 (Del. Ch. Aug. 6, 1999) (stating that when a general partner appears on both sides of a transaction with the partnership that transaction is reviewed under the entire fairness standard); *see also Emerald Partners v. Berlin*, 726 A.2d 1215, 1221 (Del. 1999).

This rule is not one grounded in our existing common law,⁷⁶ and I am not persuaded that it would be a productive innovation. Here, it is plain that Howard made clear his intention to continue to support Auto-Trol with Venhill funds. By the time period that matters, December 30, 2002 forward, it was also clear that Joe and Tatnall opposed that course of action. It is also clear that they, for reasons of family harmony and a reluctance to take action that would inevitably result in expensive and time-consuming litigation, delayed removing Howard, leaving him as general partner of Venhill, with the broad discretion Venhill's Limited Partnership Agreement vested in him.

But it is some distance from failing to remove a general partner over a policy dispute, to the point of giving him the unreviewable discretion to do whatever he wishes as to that policy dispute. And that is what Howard contends for here, that the fact that Joe and Tatnall left him as general partner of Venhill means that they ratified all of the decisions he made regarding Auto-Trol as Venhill's general partner. Accepting that contention would convert a stockholders' typically multi-dimensional decision to vote for (or fail to remove) a sitting fiduciary into a powerful and crudely overbroad immunity from liability.

Using the traditional principles governing their use, the doctrines of acquiescence and ratification do not aid Howard. Rather than acquiesce in Howard's Auto-Trol

⁷⁶ For example, in *In re Wheelabrator Technologies, Inc. Shareholders Litigation*, then-Vice Chancellor Jacobs described three factual circumstances that are commonly lumped into the term "shareholder ratification," all of which required approval in a vote of shareholders. 663 A.2d 1194, 1201 n.4 (Del. Ch. 1995).

strategy, by the beginning of this century it was clear that Joe and Tatnall emphatically opposed it. Nothing they did gave Howard any reason to believe that they approved his desire to continue funding Auto-Trol.⁷⁷ Likewise, the doctrine of ratification does not avail Howard as Joe and Tatnall never gave assent to any of the particular investments Howard caused Venhill to make in Auto-Trol on or after December 30, 2002. To the contrary, they openly opposed all such investments and never were asked to approve any particular investment decision.⁷⁸

In this regard, it is also important to note that Howard was not forthcoming with information about his activities as Venhill's general partner. Although it was clear he was continuing to pour money into Auto-Trol, Howard engaged in several transactions without any advance notice to Joe and Tatnall. He simply did as he pleased, and concealed from the Trustees instances of self-dealing payments to himself. This factual scenario is therefore far different than that to which the doctrines of acquiescence or ratification typically apply, which is when a stockholder is informed of all the material

⁷⁷ The doctrine of acquiescence requires that the party who is alleged to have acquiesced to conduct "lead[] the other party to believe the act has been approved," something Joe and Tatnall clearly did not do. *Julin v. Julin*, 787 A.2d 82, 84 (Del. 2001); see also DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY § 13-3 (2008) (stating that "[a]cquiescence arises when a party complaining of an act (1) has full knowledge of his rights and all material facts and (2) remains inactive for a considerable time, or freely gives recognition to the act or conducts himself in a manner inconsistent with any subsequent repudiation of the act, *thereby leading the other party to believe that the act has been approved*") (emphasis added).

⁷⁸ Under these circumstances, no assumption of consent on Howard's part would have been reasonable. See RESTATEMENT (THIRD) OF AGENCY § 4.04 (2006) ("A person ratifies an act by manifesting assent that the act shall affect the person's legal relations, or conduct that *justifies a reasonable assumption that the person so consents*. . . .") (emphasis added) (internal subsections omitted); *Lewis v. Vogelstein*, 699 A.2d 327, 334 (Del. Ch. 1997) (stating that "[r]atification is a concept deriving from the law of agency") (citing RESTATEMENT (SECOND) OF AGENCY § 82 (1958)).

facts regarding a transaction and then, by act or deed, either acquiesces in the transaction or gives it affirmative approval.⁷⁹ Here, Howard cannot point to one decision he made from 2002 to 2005 where he gave Joe or Tatnall prior notice of the material facts and received any hint of approval from them. That is because he never sought their assent, knowing that he would not get it.

Howard's second argument has more force. The Venhill Limited Partnership Agreement contains the following provision:

Section 14.1. Exoneration. The General Partner shall not be liable to the Partnership or the Limited Partners for any act or omission based upon errors in judgment or other fault in connection with the business or affairs of the Partnership so long as the General Partner *acts in good faith and is not found to be guilty of gross negligence or willful or wanton misconduct with respect thereto*. It shall be conclusively presumed and established that the General Partner has acted in good faith with respect to any action taken

⁷⁹ See, e.g., *In re Wheelabrator Tech., Inc. S'holders Litig.*, 663 A.2d at 1201 n.4 (describing the typical scenarios for stockholder ratification). For this same reason, I refuse to accept Howard's novel argument that the failure of Joe and Tatnall to remove him earlier constituted a failure by the Trusts to mitigate their damages. See *Brzoska v. Olson*, 668 A.2d 1355, 1368 (Del. 1995) ("A party has a general duty to mitigate damages if it is feasible to do so."). Each investment decision made by Howard was a new breach, and mitigation only applies to damages occurring after a breach. See, e.g., RESTATEMENT (SECOND) OF TORTS § 918 (1977) ("[O]ne injured by the tort of another is not entitled to recover for any harm that he could have avoided by the use of reasonable effort or expenditure *after* the commission of a tort.") (emphasis added); cf. *Lynch v. Vickers Energy Corp.*, 429 A.2d 497, 504 (Del. 1981) (holding stockholders were not barred from recovering damages merely because open market purchases of corporate stock might have been made in mitigation of out-of-pocket damages for breach of fiduciary duty), *overruled on other grounds by Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983). More important, for the same reasons I do not believe that an equity holder's failure to remove a fiduciary who has embarked on a course of action the equity holder believes imprudent constitutes an acquiescence in the fiduciary's decisions, I do not believe that such a failure bars the equity holder from recovering if she proves that the fiduciary's further actions involved breaches of fiduciary duty. Certainly, that the fiduciary was forthright about his intentions is a useful fact to him in defending the breach of duty claim, but such forthrightness does not thereby give the fiduciary the chance to put the equity holder to a stark decision to either remove him or give him a blank check to engage in activity free from the restraints of equitable review. Equity holders have a variety of tools of self-protection at their disposal, and the failure to use the power of removal does not thereby deprive them of their independent right to sue.

or omitted by him on the advice of independent legal counsel or independent outside consultants.⁸⁰

The parties engage in a terse and not particularly helpful duel regarding whether § 14.1 was intended to reach claims implicating the general partner's duty of loyalty under traditional default principles of fiduciary responsibility and what, if any, effect § 14.1 has on the court's use of the entire fairness standard. For his part, Howard says that § 14.1 is clear and immunizes him from liability to Venhill or its limited partners unless it is shown that he: 1) engaged in bad faith acts; 2) made grossly negligent decisions; or 3) committed acts of willful and wanton misconduct. For their part, the plaintiffs say that any modification of default rules of fiduciary duty must be made plain and that § 14.1 is, at most, directed at due care claims.

On this score, Howard has the better of the argument. An important reality influences that conclusion, a reality that neither party focuses upon. The entire fairness test is, at its core, an inquiry designed to assess whether a self-dealing transaction should be respected or set aside in equity. It has only a crude and potentially misleading relationship to the liability any particular fiduciary has for involvement in a self-dealing transaction. In the typical corporate context for example, one can imagine a transaction in which one of a five-member board of directors, who owns the largest bloc of shares in the company, has a self-dealing interest. Further suppose that one of the board members is the CEO, two of the other board members are the brother-in-law and first cousin of the self-dealing director respectively, and that the other board member is by status

⁸⁰ Venhill LP Agreement § 14.1.

independent of both. An exculpatory charter provision is in place, in accordance with § 102(b)(7) of the DGCL. No procedural protections are used to approve the transaction which cannot now be practicably unwound, the court uses the entire fairness standard to evaluate the transaction in a derivative suit, and finds that the transaction was unfair. As I understand it, only the self-dealing director would be subject to damages liability for the gap between a fair price and the deal price without an inquiry into his subjective state of mind.⁸¹ Why? Because under the traditional operation of the entire fairness standard, the self-dealing director would have breached his duty of loyalty if the transaction was unfair, regardless of whether he acted in subjective good faith. After all, that is the central insight of the entire fairness test, which is that when a fiduciary self-deals he might unfairly advantage himself even if he is subjectively attempting to avoid doing so.⁸²

⁸¹ *E.g., In re Emerging Commc'n, Inc., S'holders Litig.*, 2004 WL 1305745, at *38 (Del. Ch. 2004) (engaging in a director by director monetary liability analysis for the approval of a self-interested going-private transaction that was held not to be entirely fair to the corporation “because the nature of [the directors’] breach of duty (if any), and whether they are exculpated from liability for that breach, can vary for each director”); *see also* William T. Allen et al., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, 1301-02 (2001) (“In cases where the transaction cannot be undone, the court must conduct a director-by-director inquiry into which specific directors actually engaged in a breach of fiduciary duty sufficient to justify monetary liability. The fact that a transaction is found to be ‘unfair’ does not necessarily mean that all the directors have the same exposure to liability. Where the corporation has a charter provision that exculpates directors from monetary liability for breaching their duty of care, *the plaintiff must establish that a director who had no conflicting self-interest in the transaction nonetheless acted in bad faith.* If a director did not benefit from the unfair transaction, the plaintiff who seeks to subject that director to money damages liability should have the burden to prove that the director *consciously* breached his duties to the corporation.”) (emphasis added).

⁸² *In re PNB Holding Co. S'holders Litig.*, 2006 WL 2403999, at *12 (Del. Ch. 2006) (observing that “the core insight of the entire fairness standard . . . [is that] even when acting in subjective good faith, a person who stands on one side of a transaction may not act fairly towards the

But as to the other directors, even the ones who might be deemed non-independent by status, the presence of the exculpatory charter provision would require an examination of their state of mind, in order to determine whether they breached their duty of loyalty by approving the transaction in bad faith to benefit their relative, rather than in a good faith effort to benefit the corporation.⁸³ If those directors acted in the good faith belief that they were pursuing the corporation's best interests — that is, with a loyal state of mind — their failure to procure a fair result does not expose them to liability, because the charter provision immunized them from liability for mere violations of the duty of care.⁸⁴ In other words, their status as a relative of the self-dealing director is only a fact relevant to the ultimate determination whether they complied with their fiduciary duties, it is not a status crime making them a guarantor of the fairness of the transaction.

As applied to this case, the difference between using the entire fairness test to consider whether to unwind a transaction and the analysis necessary to determine whether a fiduciary is personally liable for damages resulting from a transaction is an arguably important one. Noticeably absent from this case is Auto-Trol itself. That may be because Auto-Trol's equity is entirely owned by Venhill, the Trusts, and other members of the Hillman family, and that Venhill controlled Auto-Trol (at least until Howard

person on the other side"); see *Guttman v. Huang*, 823 A.2d 492, 506 n.34 (Del. Ch. 2003) (“There might be situations when a director acts in subjective good faith and is yet not loyal (e.g., if the director is interested in a transaction subject to the entire fairness standard and cannot prove financial fairness), but there is no case in which a director can act in subjective bad faith towards the corporation and act loyally.”).

⁸³ See *In re Emerging Commc'n, Inc., S'holders Litig.*, 2004 WL 1305745, at *38 (engaging in such an analysis).

⁸⁴ *Emerald Partners v. Berlin*, 787 A.2d 85, 98 (Del. 2001).

placed Auto-Trol under the control of HMC). The plaintiffs may have thought that having Venhill, Howard, HMC, and the Trusts before the court was enough.

But in this lawsuit, the plaintiffs primarily seek to hold Howard, as general partner, “liable to the Partnership [i.e., Venhill]” and “the Limited Partners [i.e., the Trusts]” for “act[s] based upon errors in judgment or other fault in connection with the business or affairs of the Partnership.”⁸⁵ By its plain terms, § 14.1 prevents them from recovering from Howard unless he acted in bad faith, with gross negligence, or engaged in willful and wanton misconduct.

Although the relationship that § 14.1 has to the traditional entire fairness standard is a bit unusual, it does not suffer from any linguistic lack of clarity. I say unusual because § 14.1 is unlike a traditional exculpatory provision in the corporate context which usually insulates directors from liability for gross negligence.⁸⁶ Section 14.1 does not do that, and expressly subjects Howard to liability for grossly negligent acts.

But unlike a traditional exculpatory provision in the corporate context, § 14.1 appears to immunize Howard from personal liability for engaging in self-dealing transactions that, while subjectively well-motivated in the sense that they were undertaken in the good faith belief that they would benefit Venhill, were substantively unfair. That is, in a circumstance when the court found that Howard acted in good faith and without gross negligence, but simply failed to meet the fairness mark by human error,

⁸⁵ Venhill LP Agreement § 14.1.

⁸⁶ *Malpiede v. Townson*, 780 A.2d 1075, 1094-95 (Del. 2001) (stating that “even if the plaintiffs had stated a claim for gross negligence, such a well-pleaded claim is unavailing because defendants have brought forth the Section 102(b)(7) charter provision that bars such claims”).

§ 14.1 seems to insulate him for an award of damages. Read in this way, the Venhill Limited Partnership Agreement would preserve the ability of Venhill limited partners to enjoin an unfair, self-dealing transaction in advance of its consummation, but they could only recover damages from the general partner after such a transaction is consummated if his conduct in connection with the transaction was in bad faith or grossly negligent.

In clashing over this issue, the parties have not burdened me with any consideration of the status of the Delaware Revised Uniform Limited Partnership Act (the “DRULPA”) as of 1984, when the Venhill Limited Partnership Agreement was executed. Although the DRULPA became effective in 1983, it was not until 1990 that Delaware’s General Assembly amended the DRULPA to explicitly allow modification of a partner’s fiduciary duties to the limited partnership. But, one respected commentator has written that the addition of § 17-1101(d) of the DRULPA merely clarified prior decisional law that allowed partners to modify fiduciary duties through the partnership agreement.⁸⁷ In that same vein, Venhill’s Limited Partnership Agreement expresses an intent to be governed by the terms of the DRULPA as they exist in the present day.⁸⁸

⁸⁷ Larry E. Ribstein, *Unlimited Contracting in the Delaware Limited Partnership and Its Implications for Corporate Law*, 16 J. CORP. L. 299, 301 (1991) (“The new Delaware provision [that explicitly allows modification of a partner’s fiduciary duties in a limited partnership agreement] is more a clarification of prior partnership law than a change. The Uniform Partnership Act, which is applicable to limited partnerships [to the extent there are no contrary provisions in the limited partnership statute], provides that a partner is accountable only for those benefits that are ‘derived . . . without the consent of the other partners.’ Consistent with this provision, some courts have enforced partnership agreement provisions that permit partners to engage in conduct that would otherwise breach the partners’ fiduciary duties.”) (citations removed, omission in original) (quoting UNIFORM PARTNERSHIP ACT § 21 (1969)).

⁸⁸ See Venhill LP Agreement §§ 1.1, 2.1 (Venhill is to be governed by “the Delaware Uniform Limited Partnership Act, *as amended*”) (emphasis added).

Thus, on balance, it seems likely that the Venhill Limited Partnership Agreement insulates Howard from liability if his dealings with Auto-Trol were unfair to Venhill but well-motivated and undertaken without gross negligence. That is an entirely hypothetical issue, given the factual record before the court. As I next discuss, even if Howard's reading of § 14.1 is correct, he is liable to the plaintiffs for damages because he acted in bad faith and with gross negligence, and engaged in willful misconduct.

C. The Transactions Howard Caused Venhill To Enter With Auto-Trol From December 30, 2002 To July 26, 2005 Were Unfair — And Howard Knew It

1. Howard Flunks The Entire Fairness Test

In coming to the conclusion that Howard acted in bad faith and with gross negligence and engaged in willful misconduct, it is useful to apply the entire fairness standard initially to examine the transactions he caused Venhill to enter into with Auto-Trol from December 30, 2002 forward. That examination surfaces Howard's disregard for the best interests of Venhill and its investors. As is well known, the entire fairness test requires the court to consider the process used to implement a transaction, and the substantive terms of the transaction, all in aid of coming to a singular conclusion about the fairness of the transaction.⁸⁹

I therefore begin my analysis with a consideration of the process used by Howard in determining to loan money to Auto-Trol during the period between December 30, 2002

⁸⁹ *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983).

and July 26, 2005.⁹⁰ It is impossible to detail all the ways in which the process fell short of fair. I will stick to the key points.

First, Howard never attempted any kind of market check. There were at least two market checks that were advisable each time Howard caused Venhill to put additional funds at risk in Auto-Trol. The initial one was to consider whether Venhill would likely profit more from investing more in Auto-Trol or other investments available in the marketplace. These investments could have been other private equity investments, publicly traded securities, or other instruments. In fact, that sort of consideration should also have involved whether Venhill should return cash to the Trusts, if it had no uses for the cash that were attractive, when the prospects for returns and potential risks were considered. Howard never engaged in any calculus of this kind. He simply put money into Auto-Trol whenever he felt it needed cash, never considering whether that money could earn a higher return, at lower risk, by being deployed elsewhere.

The other market check Howard never did was to consider what terms Venhill should be receiving given Auto-Trol's essential insolvency and inability to procure financing from third-parties. Howard has conceded that during this period, Auto-Trol had no prospect of receiving funding from third-parties. Howard unilaterally exercised dominion over Auto-Trol and could have undertaken a test of its market worth. He did not do so. Yet, he caused Venhill to lend funds to Auto-Trol at the AFR rate, a rate that is "nearly always lower than AAA yields, the interest rate paid on corporate bonds issued

⁹⁰ An inquiry into fair dealing "embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the [decision-maker], and how the approvals . . . were obtained." *Id.*

by the most creditworthy US companies.”⁹¹ Moreover, he required Auto-Trol only to make payments annually and pushed the principal due date out until January 28, 2020. Any bare consideration of the distressed debt and equity markets would have revealed to Howard that the terms he was setting were far less advantageous to Venhill than market. Howard, of course, knew that.

Howard recognized that if he retained an investment banker for Auto-Trol to find outside investors, the overwhelming likelihood was that outside investors would only invest through a transaction that had the effect of wiping out the substantial debt and equity overhang that Howard had racked up. If — and this is a big if — Auto-Trol had some technology and personnel of value, an outside investor might have given Venhill and Auto-Trol’s other creditors a goodbye payment, but that was the limit and would have left Venhill having lost the vast majority of its investment. In such an examination, a disinterested private equity investor in Howard’s position would have found that investors putting funds into companies much stronger than Auto-Trol would have required interest rates, repayment terms, debt covenants, and control rights far in excess of what he was extracting for Venhill.⁹²

Howard is a bright man. He knew what a market test of Auto-Trol’s worth would have revealed. Being obstinately committed to pursuing his vision for Auto-Trol, Howard purposely blinded himself to market realities.

⁹¹ See PX 115 (“Metrick Report”) at 8 & Ex. 4.

⁹² See, e.g., Tr. at 940-42.

Second, and relatedly, Howard failed to seek the advice of competent professionals who could provide objective advice on Auto-Trol's prospects and the terms, if any, on which Venhill could prudently entrust more capital to it. At trial, Howard claimed that he was capable of objectively considering the best interests of Venhill, and determining how to price transactions between it and Auto-Trol in a manner that was fair to Venhill. But Howard was Auto-Trol's chairman and CEO and Auto-Trol was his personal passion. It is precisely in these sorts of circumstances when it is most useful to get outside advice. In most complex matters, it is wise for fallible humans to consult with others; doing so minimizes, but does not eliminate, the risk of missing a key consideration or failing to identify and then grapple with relevant information. In situations where the key decision-maker is on both sides of the transaction, outside advisors also help check the potential that the conflicted party's personal motivations will cause the consummation of a transaction that should have been avoided or, at the very least, been priced much differently. Howard eschewed any outside advice and, in fact, reacted to any questioning of the wisdom of continuing to fund Auto-Trol angrily and not rationally, choosing to seclude himself from any outside thinking that might differ from his own.

Third, Howard's analytical process was, well, non-existent. From a rational perspective, the fact that Venhill had invested \$67,850,000 in Auto-Trol as of December 30, 2002 was largely irrelevant to its future investment decisions. Howard's own trial expert agrees that the funds Venhill had already invested in Auto-Trol at any particular point should not have factored into Howard's decision to invest more money into the

company.⁹³ I agree with Dr. Kursh that the question of whether “specific investments . . . could have provided positive financial returns . . . going forward” is an important focus for my analysis.⁹⁴

In choosing between two new potential investments of roughly the same size as an average loan to Auto-Trol, say \$200,000, a disinterested general partner at Venhill should have evaluated which investment would have returned more capital to Venhill. That rational, disinterested (and hypothetical) general partner would be indifferent between a non-Auto-Trol investment yielding \$300,000, and a loan to Auto-Trol that led to Auto-Trol retiring \$300,000 of the vast sum of money it owed Venhill. The key question is which investment was, considering the relevant risks, likely to provide the highest return. For precisely that reason, venture capitalists and private equity investors carefully analyze each additional investment they make into a portfolio company.

In that process, it is common for them to demand that the company seeking capital present detailed plans regarding their proposed use of funds, their business plan, and the cycle on which they expect the company to reach profitability. Future funding (or even tranches of a single funding commitment) is often conditioned on the attainment of certain benchmarks. In fact, the failure to attain a certain level of success may subject the managers of the company to removal at the instance of the investing entity. Investors putting capital at substantial risk recognize that they will often make losing bets even when an entrepreneur has a well-thought out strategy. But that is exactly why they go

⁹³ Kursh Report at 10; Tr. at 1001.

⁹⁴ Kursh Report at 10.

through the rigor of requiring the entrepreneur to make her case, by presenting a specific business plan with real benchmarks, and testing the entrepreneur's plan against their own industry knowledge and experience.

Howard did not engage in any thinking of this kind. To be candid, I left the trial concluding that Auto-Trol has been entirely improvisational and has had a shifting and unfocused business plan. This is not a minor problem in a corporation that is generations, not months old. Auto-Trol is not a start-up. Indeed, Auto-Trol's consistent record of failure would have caused any outside investor considering the company to demand that Auto-Trol's management be even more specific and clear about the company's business plans and when management thought it would become profitable.

Howard never developed such a plan for Auto-Trol, much less used the achievement of benchmarks in the plan as a pre-condition to further infusions of capital from Venhill. Rather, he simply made ad hoc loans to Auto-Trol from Venhill whenever Auto-Trol needed cash, never examining whether Auto-Trol was on a course toward sustained profitability. As a result, he never made any rational attempt to exercise the type of disciplined thinking that most durably successful private equity and venture capital investors employ.

For all these reasons, the process used by Howard to make investment decisions for Venhill regarding Auto-Trol was grossly deficient. And, not surprisingly, the absence of a fair process relates to my consideration of the substantive fairness of the transactions.

Let us begin with the nature of the transactions. These were loans made during the period December 30, 2002 to July 26, 2005 at a very low rate of interest and with weak

repayment terms. Thus, the upside of these loans was low. The only way they could be conceived of as making any sense was if by making them, Venhill was facilitating a turn-around at Auto-Trol that would make it able to repay the \$15,950,000 Auto-Trol already owed to Venhill as of December 30, 2002 and would receive a high rate of return in that sense.⁹⁵

For that to be a rational basis for an investing decision by Venhill, Auto-Trol had to have a business plan that showed how in some commercially reasonable timeframe it would, through the sale of services and products, attain profitability on a durable basis, sufficient to enable it to repay Venhill for principal and interest, and to meet its future cash needs on its own. Howard and his management team at Auto-Trol never prepared such a plan, and even under the pressure of litigation, never formulated a sensible, comprehensible business strategy.

It may well be that Auto-Trol has developed some useful products over the years. But that does not mean that it was or is a sound business. By 2003, Auto-Trol had been insolvent for a decade, only remaining afloat because of infusions of nearly cost-free capital from Venhill. No rational person would have put good money after bad without some rational business plan for a turn-around at Auto-Trol. Howard lacked one.

Given that, it was obviously imprudent for Venhill to provide low-interest, payment deferred loans to Auto-Trol of another \$17,870,000 between December 30, 2002 and July 26, 2005. If Venhill — which had been formed to make risky investments

⁹⁵ In other words, because a large proportion of Auto-Trol's debt to Venhill by this time period was unrecoverable, any additional recovery of that debt resulting from a new loan from Venhill could be considered as part of the return on investment for that new loan.

yielding high returns — was going to make loans, it could have easily found more credit-worthy borrowers willing to pay a higher interest rate and make more regular payments. That is, it could have easily achieved a higher expected rate of return at much lower risk. Instead of doing so, Howard caused Venhill to provide Auto-Trol with loans at rates and on terms no rational lender would have tolerated. Indeed, Howard himself admits that no rational third-party would have financed Auto-Trol on the terms he did. That is unsurprising because even AAA-rated borrowers could not get such a sweet deal from a lender.

As or more egregious was Howard's decision on January 28, 2005 to roll all of the nearly \$31,520,000 in debt Auto-Trol owed Venhill into a single note, not payable until January 28, 2020.⁹⁶ Howard's only defense to this is that Venhill already essentially owned all of Auto-Trol's debt and equity, so what was the harm to pushing out the debt to itself another 15 years? But again, the coming of the due date on a large series of debt is the sort of inflection point that causes a rational investor to think deeply about winding up the business if the business cannot meet its repayment obligations. It is not a time for the inertial deepening of a financial sinkhole.

Howard's own admission of Auto-Trol's value further demonstrates that these transactions were unfair. If Howard truly believed that Auto-Trol had real equity value, in the sense that it could pay off its debts and have a surplus for its stockholders, he would have been anxious to try to buy Auto-Trol for a fraction of its debt obligations (say \$15 million) and see if its creditors would accept that, and to take the upside for himself.

⁹⁶ PX 85.

By his conduct in arguing that Auto-Trol's equity was worth only \$1 and his unwillingness to pay off any of the substantial debt Auto-Trol owned, Howard essentially admitted that there was little or no prospect that Auto-Trol would ever succeed to the point where it could pay off the \$21 million in debt that it owed to Venhill at that time, let alone pay back the massive \$73 million in investment capital that Venhill had invested in Auto-Trol before the debt re-characterizations. Given this admission, his decision to keep pouring money in on submarket terms was obviously unfair to Venhill.

Even considered in narrower terms, the loans from Venhill to Auto-Trol from December 30, 2002 forward were grossly unfair to Venhill. Auto-Trol was insolvent, with financial metrics worse than a median company with credit ratings considered to be "predominately speculative, substantial risk, or in default."⁹⁷ Despite that, Howard demanded it only pay the AFR rates, rates that were lower than the yields on AAA bonds, "the interest rate paid on corporate bonds by the most creditworthy U.S. companies."⁹⁸ Given the huge risk of default that existed because Auto-Trol was already incapable of servicing its existing debt to Venhill, it is impossible to imagine a rational fiduciary putting principle at risk for an AFR return, from a company that had only once in the last 9 years repaid the principal of a loan.

Likewise, the other terms of the loans were unfair to Venhill. At this stage of failure by Auto-Trol, it was likely that any other rational private equity sponsor would have shut down the firm, salvaged what it could through an asset sale, and moved on. At

⁹⁷ Metrick Report at 8 (citation omitted).

⁹⁸ *Id.*

the very least, any additional investments would have been on terms that involved a very high rate of interest, the potential for an upside through warrants or a conversion feature, and triggers that allowed the investor to exercise direct control over Auto-Trol if its management continued to fail to achieve success.⁹⁹ Howard extracted none of these protections for Venhill.

Finally, no rational investor would have allowed Venhill to imbalance its portfolio so strongly toward Auto-Trol. Given Auto-Trol's record of failure and lack of reasonable growth prospects, it was unlikely to have been any investor's choice as an investment at all. But what is clear is that if an investor was going to take a big bet by putting over 50% of his portfolio in one investment, it would not have been on Auto-Trol. For Howard to have tilted Venhill's portfolio so heavily toward Auto-Trol was obviously imprudent, and something that no rational investor would have done. Even high-risk venture capital and private equity investors do not typically bet more than 20% of their portfolio on one company. To put over 50% of a portfolio into a company that has been essentially insolvent for a decade or more would be unthinkable to a rational high-risk investor.¹⁰⁰

For all reasons, I conclude that all of the investments and transactions Howard caused Venhill to make into or with Auto-Trol from December 30, 2002 to the present were unfair to Venhill.

⁹⁹ Howard's own expert admitted as much at trial. Tr. at 941-942; *see also id.* at 952-53.

¹⁰⁰ Metrick Report at 9-10 ("In general, PE funds would rarely allocate more than 20 percent of their portfolio to a single company, and I have never heard of an allocation reaching 50 percent.").

2. Howard Knew He Was Acting Imprudently

Howard's lawyers have tried to convince me that Howard was a true believer, who subjectively believed all along the way that Auto-Trol would turn out to be a financial success. I do not believe that to be the case.

At least by this century, Howard himself had no subjective belief that Auto-Trol would be successful in the sense relevant to a for-profit business. By that, I mean that Howard did not believe that Auto-Trol would develop and sell sufficient products and services to pay off its debt-holders and make a decent return to its equity holders. In fact, I am convinced Howard knew that Auto-Trol had essentially no prospect of paying off Venhill and its other debt-holders.

If Howard had a genuine belief in the value of Auto-Trol, he could have put his money where his mouth was. He could have offered to buy Auto-Trol in a transaction paying off all, half, or even a quarter of Auto-Trol's debts. He could have convinced his children to help him fund his dream, using funds from their family Trusts, without drawing on funds from Trusts for Tatnall and his children. When the Hempstead Valuation came out in 2003, Howard was presented with a great opportunity to deal. But his actions were consistent with what I find was his true belief, which is that Auto-Trol was insolvent, could not pay off its debts, and could only be kept alive by ongoing infusions of cash by a source that did not demand timely repayment.

This does not mean that Howard was not devoted to Auto-Trol. Indeed, that is the problem. It is clear that Howard derived much of his personal identity and satisfaction

from being the CEO of Auto-Trol. Auto-Trol was the vehicle by which he was going to prove himself.

By this century, though, Howard knew that Auto-Trol was not going to be successful as a business. But he was dug in.

Howard believed his brother Tatnall was a lazy and ungrateful dilettante, who had spent his adult life having fun while Howard did the hard work for the family. Howard resented that Tatnall and their cousin Joe (who Howard viewed as an interloping intermeddler) would not recognize all Howard had done for the family and let him pursue his dreams at Auto-Trol. And, most of all, Howard was not going to confess error or defeat by admitting that it was time to pack it in, sell Auto-Trol, and cut the family's losses.

Instead, he played a high-stakes game of chicken with his family's money, challenging and goading Joe and Tatnall into a confrontation. Howard's personal pride would not let him back down, and the plush circumstances afforded to him by the Trusts allowed him to play a game of brinksmanship without personal consequence.

Howard is a smart man. He knew that Venhill could get a better return at lower risk by putting its funds elsewhere than in Auto-Trol. He knew that he was lending Venhill funds in Auto-Trol on terms unfair to Venhill, and that there was little or no chance Venhill would be repaid. He knew that Auto-Trol had no business strategy that would enable it to pay back the huge debt it already owed to Venhill.

But Howard did not care because he found the continued operation of Auto-Trol personally satisfying, as he enjoyed being a CEO, thinking about the company's products

and research, and interacting with the employees. Howard seems to have harbored the belief that Tatnall owed it to him to allow him to pursue his passion with Venhill's money, as an act of grace in exchange for Howard's work on behalf of the Trusts over the years and Howard's savvy that led to their wealth in the first place. Professor Metrick accurately described Auto-Trol as Howard's "hobby,"¹⁰¹ but it was a hobby he funded with other people's money.

Regrettably, this was also a situation that only became worse with time. The more objectively bleak the situation was, the more stuck in Howard got. He did not approach this issue with a cool head, considering whether it was time to wind up Auto-Trol, cut Venhill's losses and move on to more profitable ventures. Instead, the more that Joe and Tatnall questioned him, the more Howard blinded himself to objective reality and simply forged ahead.

That Howard's actions were not selfless is also demonstrated by his willingness to treat himself and his children differently than Venhill. Even though Auto-Trol was cash-strapped, Howard had it funnel money back to him and to the Vineyard Trust that benefited his family.

This is a clear case of fiduciary disloyalty. Although Howard's motives were not financial enrichment, they were personal.¹⁰² He preferred the continuation of his hobby

¹⁰¹ Tr. at 426, 446.

¹⁰² See *In re RJR Nabisco, Inc. S'holders Litig.*, 1989 WL 7036, at *15 (Del. Ch. Jan. 31, 1989) ("Greed is not the only human emotion that can pull one from the path of propriety; so might hatred, lust, envy, revenge, or, as is here alleged, shame or pride. Indeed any human emotion may cause a director to place his own interests, preferences or appetites before the welfare of the corporation. . . . In such a case, is it not apparent that such a director would be required to

and let a stubborn sense of pride and an unwillingness to admit error come ahead of his duties to Venhill. Howard knew he was injuring Venhill to benefit his personal interest in continuing Auto-Trol as a hobby. That is, Howard did not act in the good faith pursuit of Venhill's best interests, as he was bound to do. Instead, he acted in bad faith by impoverishing Venhill in order to keep Auto-Trol afloat for personal reasons unrelated to Venhill's own best interests. Given that he knew that he was investing Venhill's funds in an imprudent and irrational manner, Howard also engaged in willful misconduct. Therefore, § 14.1, the exoneration clause of the Venhill Limited Partnership Agreement, does not insulate him from liability for his breaches of duty.

Section 14.1 does not aid Howard for another reason, which is that it is obvious that he acted in a grossly negligent manner. His decisions did not involve any rational consideration of relevant factors. He did not make any genuine effort to comply with the expected duty of care. No rational investor would have made the decisions Howard did, or in the manner he did.

V. What Is The Appropriate Remedy For Howard's Breaches Of Duty?

This court has broad discretion in determining an appropriate remedy for Howard's breaches of fiduciary duties.¹⁰³ In cases of this kind, it is rare for the record to permit the court to enter a remedial order that derives arithmetically from the application

demonstrate that the corporation had not been injured and to remedy any injury that appears to have been occasioned by such transaction?").

¹⁰³ See *Int'l Telecharge, Inc. v. Bomarko, Inc.*, 766 A.2d 437, 440 (Del. 2000) ("In determining damages, the powers of the Court of Chancery are very broad in fashioning equitable and monetary relief under the entire fairness standard as may be appropriate, including rescissory damages.") (internal citations omitted); see also *Weinberger*, 457 A.2d at 714 (similar).

of a financial formula to undisputed facts. Rather, the court's task is to fashion a sensible, rational remedy grounded in the record and relevant principles of finance and economics, bearing in mind the policy in favor of generous awards to remedy breaches of the fiduciary duty of loyalty.¹⁰⁴

Here, the primary dispute among the parties about the shape of any remedy is how to calculate the damages suffered by Venhill as a result of the loans Howard caused it to make to Auto-Trol from December 30, 2002 to July 26, 2005. The parties agreed that these totaled some \$17,870,000.

They also agree that analytically the difficult question to be answered is what lost profits Venhill suffered on top of the loss of principal as a result of Howard's decision to loan those funds to Auto-Trol rather than to invest them in other opportunities. A great deal of trial time and briefing and expert report space was taken up with a debate over what measure to use in calculating Venhill's lost investment profits. This issue was complicated by the fact that Venhill (under Howard's managerial control) did not maintain books and records that make it easy to determine how its non-Auto-Trol investments have performed over time, and that the parties did not submit any credible or

¹⁰⁴ *Thorpe v. CERBCO, Inc.*, 676 A.2d 436, 445 (Del. 1996) (“Delaware law dictates that the scope of recovery for a breach of the duty of loyalty is not to be determined narrowly.”); *In re Primedia Inc. Derivative Litig.*, 910 A.2d 248, 262 (Del. Ch. 2006) (“As the Delaware Supreme Court long ago noted, the duty of loyalty ‘does not rest upon the narrow ground of injury or damage to the corporation resulting from a betrayal of confidence, but upon a broader foundation of a wise public policy that, for purposes of removing all temptation, extinguishes all possibility of profit flowing from the breach of confidence imposed by the fiduciary relation.’”) (quoting *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939)).

clear showing of the rate of return Venhill achieved during the time period relevant to this remedy determination.

What is clear, however, is that Venhill was formed by the Trusts to seek a return higher than could be achieved simply by investing in common stocks. Howard admits as much,¹⁰⁵ and believed that Venhill's other investments generated a rate of return higher than the Standard & Poor's 500 Index (the "S&P 500").¹⁰⁶ Indeed, it would have been irrational to form Venhill simply to achieve a return that the Trusts could have attained at lower cost and at much lower risk simply by investing in an index fund. Venhill was embarked on the mission of seeking better than market returns, a mission that necessarily involved taking some greater risks in several senses, including having less ability to diversify away risk. In fact, one reason why Howard's loans to Auto-Trol were so obviously improper is that they involved the pursuit of a below-market return (a negligible interest rate return with weak repayment terms) at a huge risk (an insolvent borrower already in deep default to Venhill).

For this reason, even Howard's expert did not point to the S&P 500 as the appropriate benchmark for measuring Venhill's lost profits. Instead, Kursh argued that because Auto-Trol was a software company, the right measure was what Venhill would have made if it had invested in other computer companies.

I reject that notion, because there is no basis to believe that Venhill was formed to concentrate on computer industry investments. Howard's obsession with Auto-Trol did

¹⁰⁵ Tr. at 273, 287-88.

¹⁰⁶ *Id.* at 21.

not turn Venhill into a specialized computer industry investment fund. Nothing in the record supports that inference, or the inference that Venhill's other investments did not involve a diverse array of industries.

Rather, what is clear is that the measure that is most consistent with Venhill's objective is one that measures what Venhill would likely have received by making high-risk venture capital and private equity investments. The plaintiffs' expert, Professor Metrick, persuasively testified that the database called VentureXpert provides a sound estimate for average annual returns achieved by investors in these sectors. Using VentureXpert, and data available from Venhill, the plaintiffs' damages expert Arthur Baines of PricewaterhouseCoopers calculated the return Venhill would have made if instead of loaning nearly \$18 million to Auto-Trol from December 30, 2002 until July 26, 2005, it had invested in venture capital and private equity investments. In coming up with the calculation, Baines gave Howard credit for the fact that, based on the books and records available, Venhill had invested in some marketable securities and had kept some cash on hand. He therefore applied the VentureXpert rate only to the portion of Venhill's portfolio devoted to non-marketable securities and partnerships and LLCs. That was a sensible proxy for the portion of Venhill's portfolio it would have invested in investments of the type captured by VentureXpert.

At trial, Kursh raised several questions regarding the VentureXpert database. Only one was substantial, which is whether VentureXpert accounted for the failure of firms sufficiently by incorporating losses due to portfolio firm failure into its return calculation. Professor Metrick admitted that this is an unsettled issue, especially for a lag

period that is present in recent data. He was, however, convinced that VentureXpert seemed to have addressed it better than other databases and that data from VentureXpert that is over 24 months old does not reflect this concern. All three experts agreed that it would be inappropriate to use VentureXpert for the most recent two years, and as a result the plaintiffs' expert used the S&P 500 as a conservative benchmark in lieu of VentureXpert for that time period.

Because of these issues and because there is no guarantee that Venhill would have been as successful as the average venture capital investor, I am going to premise my award on two rates of return. I will first apply the VentureXpert rate of return, minus one percent per year, to all damages until two years before the date of this opinion. After that, the interest rate on the S&P 500 index will replace VentureXpert in the calculation of damages. By using these rates, I remain true to Venhill's purpose and what I know about Venhill's rate of return on non-Venhill investments, which is that Venhill obtained a return in excess of the S&P 500, but apply a tempering measure of conservatism to address the concerns over survivor bias and other uncertainties with the VentureXpert data. The plaintiffs shall recalculate their damages request — which, using VentureXpert returns, was \$28,386,824 for the period beginning December 30, 2002 — in accordance with this decision, share their calculations with Howard, and present an agreed upon figure to the court. Interest on the award will run from the period of this calculation at the legal rate, and continue to run at that rate until the judgment is satisfied.

The other remedial issues are relatively simple. As to Howard's January 1, 2003 decision to roll all of Auto-Trol's debt to Venhill into a single note, I reject the plaintiffs'

request that I pretend that Auto-Trol could have paid that debt in 2003 and invested the funds elsewhere. As to that issue, the appropriate remedy is rescission, allowing Venhill to collect on the debts based on the obligations owed to it by Auto-Trol before Howard converted that debt into a single note. This obvious remedy is complicated by the absence of Auto-Trol as a party. Therefore, I shall enter an order prohibiting Howard or any party acting in concert with him from contesting any decision by Venhill, as the controlling stockholder of Auto-Trol, from unwinding that decision.

Lastly, Howard's attempt to grant himself priority as a creditor over Venhill as a result of his unilateral decision to invest funds of himself and his children in Auto-Trol in May of 2007 will be set aside. Notably, Howard took steps to obtain a security interest in Auto-Trol's real estate for himself and his family when putting their funds at risk. This was something he had never bothered to do for Venhill, despite having made 186 loans and investments totaling over \$85 million into Auto-Trol on its behalf. Auto-Trol's obligation to Howard should be subordinated to the entirety of its debt obligation to Venhill.

In this regard, I reject Howard's argument that there should be any reduction in the damages award because Venhill has been able to use certain Auto-Trol losses to offset some capital gains liability. The fact that Venhill was able to salve some of the wound from its equity investments in Auto-Trol (the last of which occurred in 2001 through the last of Howard's improper conversions of Auto-Trol debt into equity) does nothing to

offset the harm suffered by Venhill as a result of the imprudent loans Howard caused it to make to Auto-Trol from December 30, 2002 forward.¹⁰⁷

VI. Should Howard Pay The Plaintiffs' Attorneys Fees?

The plaintiffs contend that Howard's actions are of such an egregious nature that he should bear their fees under the bad faith exception to the American Rule. That rule can create some cognitive dissonance in a case like this when I have concluded that Howard breached his duty of loyalty by undertaking action on behalf of Venhill for the bad faith reason that it advanced his personal interests and knowing that the action was unfair to Venhill. Our law, however, has not been that every case of intentional fiduciary wrongdoing justifies fee-shifting.¹⁰⁸ If it did, there would not be much left of the American Rule.¹⁰⁹

Rather, the bad faith exception applies only in cases, to use Chancellor Allen's vivid phrase, of "unusually deplorable behavior" — pre-litigation behavior, so egregious that the defendant's proffer of a litigation defense is seen as in itself an act of bad faith,

¹⁰⁷ Furthermore, the mere fact that Venhill has not shuttered the doors at Auto-Trol since Howard left at the end of 2007 does not mean that my award poses a danger that Venhill will enjoy a windfall at Howard's expense. There is no basis to believe that Auto-Trol is worth anything near the \$85.4 million Venhill invested into it. If, in the unlikely event that Stallkamp and the turn-around specialist he retained can dress up Auto-Trol and sell it for an amount that exceeds what Venhill was due considering its lost opportunities and the time value of money, Howard will benefit as the primary beneficiary of the A-1 Trust, one of Venhill's two limited partners.

¹⁰⁸ *HMG/Courtland Properties, Inc. v. Gray*, 749 A.2d 94, 124-25 (Del. Ch. 1999) ("The mere fact that a corporate director has breached his duty of loyalty to the corporation does not justify an award of attorneys' fees and expenses This exception to the American rule is 'narrow' and should be applied 'in only the most egregious instances of fraud or overreaching.'") (quoting *Boyer v. Wilmington Materials, Inc.*, 1999 WL 342326, *5 (Del. Ch. May 17, 1999)) (internal citations omitted).

¹⁰⁹ *Ryan v. Tad's Enters., Inc.*, 709 A.2d 682, 706 (Del. Ch. 1996) (stating that "[o]therwise, every adjudicated breach of fiduciary duty would automatically result in a fee award."); *see also HMG/Courtland Properties, Inc.*, 749 A.2d at 125 (quoting *Ryan*, 709 A.2d at 706).

because the plaintiff's right to relief is so obvious and the defendant has unjustifiably caused the plaintiff to expend resources in the form of money and time in securing a clear right.¹¹⁰ Here, there is only one area of the case where Howard's behavior justifies fee shifting.

His decision to usurp control of Auto-Trol from Venhill when he feared removal and to cause Venhill to make another \$2.3 million in payments to Auto-Trol and to his own attorneys was obviously improper. Yet, it was not until after trial that Howard returned control of Auto-Trol to Venhill. Even then, he did not concede that the departing payments were improper.

Howard had no good faith defense to these actions and put the plaintiffs and the court to needless burden in addressing these issues. Thus, the plaintiffs' fees and expenses attributable to those decisions shall be paid by Howard.¹¹¹ The plaintiffs shall make a conservative and well-supported showing of what those fees and expenses are, and meet and confer with Howard's counsel in an effort to agree on that amount.

¹¹⁰ *Barrows v. Bowen*, 1994 WL 514868, at *2 (Del. Ch. Sept. 7, 1994) (“While this court can imagine situations which may be so egregious as to warrant an award of attorney’s fees on the basis of fraud, the American Rule would be eviscerated if every decision holding defendants liable for fraud or the like also awarded attorney’s fees. Even more harmful would be to extend this narrow exception to situations involving less than unusually deplorable behavior.”).

¹¹¹ This includes the costs of the TRO application and settlement agreement entered to prevent the Spring 2007 Subscription Offering, which would have benefited Auto-Trol at the expense of Venhill by either compelling Venhill to infuse Auto-Trol with \$2.5 million in equity capital or severely diluting Venhill’s equity holdings. Venhill, although it owned over 95% of Auto-Trol, was unable to prevent the transaction because its voting rights were held by Howard as the unremovable manager of HMC, thereby preventing Howard’s removal. The attempted Subscription Offering, both evidences Howard’s bad faith of its own accord also resulted directly to his decision to usurp control of Auto-Trol from Venhill.

But the plaintiffs' request for all of their remaining fees and expenses is denied. This is a case where the plaintiffs knew for over a decade before they brought suit of Howard's inclination to keep investing in Auto-Trol. Yet, they brought a case demanding damages for actions going back to 1993. Given that the plaintiffs themselves complicated this action by bringing obviously time-barred claims, they are in a poor position to ask Howard to cover all of their fees and expenses for this action. Had they brought a suit focused on the appropriate time period, this case would have been far less unwieldy for all concerned. And even if they had, I cannot conclude that fee shifting under the American Rule is in order simply because Howard defended the fiduciary propriety of the investments he caused Venhill to make into Auto-Trol from 2002-2005, with the exception of the parting gifts made in connection with his transfer of Auto-Trol to HMC.

VII. Conclusion

For all these reasons, judgment will be entered for Venhill and against Howard Hillman. Within twenty days, the plaintiffs shall prepare a conforming final judgment providing for the payment of damages and interest to Venhill, addressing all other issues, and submit it, upon agreement as to form from Howard Hillman. The court recognizes that meeting this deadline will require the parties to devote immediate and substantial attention to this matter, but the deadline is achievable if the parties work cooperatively toward the required end.