March 14, 2001

To:    Legal Foundations of Finance Class
From:  Professor W. T. Allen

Our syllabus says we will treat derivatives for our last class on contracts. I am changing this for reasons I may explain in class. Instead I want to talk about joint venture contracts and fiduciary duties. The attached case which arose out of the joint venture in which Time Warner holds its entertainment assets (TWE) and certain cable assets provides a good example of a court employing some of the concepts we have discussed this semester.

(Attach US WEST v. TIME WARNER)
Increasingly, large scale business projects are undertaken in legal forms that, through complex contracting, allow for joint corporate investment and for specified allocation of managerial authority. Such forms offer evident advantages: access to capital, to specialized knowledge and relationships, and potentially to operating synergies. But, because the participants in such joint venture projects often have important investments in related businesses held outside the joint venture structure, the venturers will not have identical...
incentives in all future situations. Such differing incentives will in time lead to costly disputes unless the contractual document establishing the venture at the outset clearly resolve particular disputes in a way the parties accept later, when these differences arise. n1 This case is an example of the kind of contractual problems that this organizational form can generate.

n1 In its standard form the publicly financed corporation, with its centralized management and diversified (rationally passive) investors, reduces these costs. The publicly financed corporate form of course has other much discussed characteristic costs associated with having centralized management and disaggregated shareholders.

The joint venture involved is Time Warner Entertainment, ("TWE") a Delaware limited partnership that engages in a range of businesses[*3] including entertainment, cable television, telephony and related fields. Time Warner, Inc., a Delaware corporation, indirectly owns a 74.49% interest in TWE and, through subsidiaries, acts as its managing partner. U.S. WEST, Inc., a Delaware corporation, owns a 25.51% limited partnership interest and possesses certain management rights. This suit by U.S. WEST, Inc, (with its affiliates hereafter referred to as "US WEST") seeks an injunction against Time Warner, Inc., (hereafter, together with its relevant affiliates, referred to as "Time Warner" or "TWI") preventing Time Warner from acquiring, through merger, ownership of Turner Broadcasting System, Inc. ("TBS"), a Georgia corporation. TWI has for some years owned a substantial minority interest in TBS and is now party to an agreement by which it plans to acquire all of the stock of that company.

I.

A. Overview of the Parties’ Positions

In seeking this relief U.S. WEST asserts claimed rights under the 1993 Admission Agreement through which it invested approximately $2.5 billion in TWE in exchange for its limited partnership interest and other rights. While TWE originally had two other limited partners (the "Original Limited Partners"), by the time this suit was initiated those investors had exchanged their limited partnership interest in TWE for stock in Time Warner itself, leaving U.S. WEST as the sole limited partner of TWE.

In support of the requested relief it is alleged that Section 5.5 of the 1991 TWE Limited Partnership Agreement (as amended and restated by the 1993 Admission Agreement) precludes any partner from competing with the partnership in the business of producing and distributing video programming and filmed entertainment products, subject to certain stated exceptions. U.S. WEST asserts that TBS does complete in these businesses and that no exception to the non-competition provision authorizes Time Warner to engage in these businesses indirectly through the ownership of TBS. Furthermore, given the unique nature of its interest in TWE and the on-going nature of the threat to the welfare of TWE that U.S. WEST perceives that a TWI-TBS transaction represents, plaintiff asserts that a grant of an injunction is appropriate.

Beyond the theory predicated on a breach of amended Section 5.5 of the Partnership Agreement, U.S. WEST also asserts a second ground for relief. That claim is that TWI[*5] as a controlling general partner owes a duty of loyalty to TWE. That duty, it is said, includes the obligation not to compete with TWE in its lines of business and the duty not to take, on its
own or through other entities (in which it may have a higher proportion of the equity -- as would be the case with TBS), business opportunities that fall within TWE's line of business and that it is able to finance undertaking. Yet if the TBS acquisition is permitted to go forward, according to U.S. WEST, TWI will be placed in the impossible position of a fiduciary running competing businesses for different sets of investors. This problem is especially acute, according to U.S. WEST, because TBS has changed in significant respects since the Admission Agreement was negotiated; it now owns, as it previously did not, two movie studios (New Line Cinema and Castle Rock Entertainment, Inc.) which will compete frontally with TWE's Warner Brothers Studios. Thus, U.S. WEST claims that even if the non-competition provisions of the restated partnership agreement were deemed not to prevent this acquisition, Time Warner's duty of loyalty as a fiduciary must be deemed to do so.

Finally U.S. WEST asserts that[*6] Time Warner has deliberately mislead it by (1) failing to disclose to it an informal representation given at the time the Original Limited Partners entered into the Partnership Agreement to afford to TWE an option to acquire TBS from TWI at its fair market price, in the event that TWI thereafter acquired control of TBS, and (2) failing to inform it that Time Warner understood that Section 5.5 and Schedule 5.5 permitted TWI to acquire control of TBS without the prior consent of U.S. WEST.

In response to the first of these assertions, Time Warner concurs that in general the partners of TWE are bound by Section 5.5(a) of the amended Partnership Agreement not to compete with TWE in either the cable television business (called "Co-managed Businesses" in the Admission Agreement) or the programming or filmed entertainment businesses, but it asserts that exceptions to that prohibition originally stated in the 1991 Partnership Agreement and preserved the 1993 amendment of Section 5.5 nevertheless authorize the TBS acquisition. Thus, Time Warner most basically asserts that the language of the amended Partnership Agreement both on its face and when read in context of the relevant negotiations[*7] is inconsistent with plaintiffs' claim.

With respect to the argument that a fiduciary duty to TWE or U.S. WEST prevents or should in equity prevent it from accomplishing the planned transaction, TWI asserts first that the contract itself specifically treats the subject and that, under general principles, there is therefore no room for implying other obligations. Secondly, TWI asserts that the acquisition of TBS involves no breach of loyalty in any event. Assuming that its contract does permit the exercise of a power to increase its ownership of TBS, Time Warner says that it ought not to be presumed to be unable to operate TBS and TWE in a way that is wholly fair to the minority investor in TWE. Its dual role may present it with management challenges, but there are, it asserts, some tools available for dealing with them. First, not all programming or film opportunities that come or will come to TBS will be properly deemed opportunities of TWE. Broz v. Cellular Info. Systems, Inc., Del.Supr., 673 A.2d 148 (1996). Second, U.S. WEST might consent to the allocation of a business opportunity to which TWE might claim entitlement. Third, TWI notes its willingness to transfer TBS' programming[*8] and entertainment assets to TWE at a fair price. Finally, if its ownership of both interests created problems that were otherwise not resolvable, TWI could undertake dispositions of TBS "programming and filmed entertainment" assets and thereby avoid any question of competing with TWE. In all events, according to TWI, owning the TBS assets itself can cause no actual financial harm to TWE and
thus closing the TBS acquisition should in no event be the occasion of injunction. n2

n2 This position—that equitable relief on any fiduciary duty claim would be premature at this time since closing on the acquisition would not itself subject TWE to any greater commercial competition than it now faces—in this setting would deserve consideration even if one assumed the substantive claim to have merit. Stepping back from the details of the present dispute to look at the parties' situation, what seems apparent is that if the TWE structure ever represented a sound long-term strategic structure, it probably no longer does, at least for these parties. TWI is committed to acquiring the TBS assets; it has, for example, long coveted CNN, an asset created by TBS. For its part, U.S. WEST was not in the first place an enthusiastic investor in TWE's "content" assets (i.e. those assets dedicated to the production of video and filmed programming). Its initial interest was in TWE substantial cable systems, and it professes no interest in further substantial investment in the content end of TWE's business (assuming I suppose that such investment did not reflect a discount price) where it has no real management role. Were TBS acquired by TWI, it would appear to make the most sense to finance and manage TBS assets together with the other substantial programming and filmed entertainment assets managed by TWI affiliates through TWE. But assuming TWE remains in its present configuration, the contribution of the TBS assets to TWE would require either a substantial additional investment by U.S. WEST in "content" assets or a substantial dilution of its 25% Interest. U.S. WEST’s assent to either of these appears to be problematic. Thus, for example, the parties reported inability to agree on a transaction in the form contemplated by the "Hersch Memorandum" is not surprising. (see p.11 infra). The most sensible and likely outcome therefore appears to involve an unwinding of the TWE structure. This lawsuit can be seen as a step in that negotiation process. In this context, an argument that closing the TBS acquisition will not itself cause financial injury to TWE and thus ought not be enjoined on fiduciary principles, is an argument that touches upon important questions of timing and ought not be brushed aside as merely temporizing.

[*9]

Large stakes are at issue and thus as one can easily imagine the positions and counterpositions of the parties are greatly more elaborate and subtle than this introductory statement reflects. The facts that provide the context for the Admission Agreement are in certain important respects contested. In all events, the foregoing summary of the issue and the positions of the parties may do as a quick first glance over the battlefield across which are arrayed a profusion of factual and legal disagreements.

B. Procedural Setting

The complaint was filed on September 22, 1995 and the parties agreed to an intensive discovery schedule and an early trial. Following discovery and only weeks before the scheduled trial, TWI filed a motion for judgment on the pleadings. It asserted that the relevant contractual documents made it unambiguously clear that it was permitted to acquire control of TBS. That motion, which U.S. WEST of course resisted, was not decided. Rather, in an effort to reach a conclusive final adjudication as promptly as possible, I reserved decision on it in order to permit the creation of an evidentiary record at trial. This exercise of discretion was not
premised[*10] upon an unstated view of the merits of that motion, but on an understanding of the fallibility of human judgment: even if TWI were to prevail on its pretrial motion, there would exist risk that a trial might nevertheless be required on remand of an appeal of that decision. Thus, given the parties' need for a prompt and final determination, that motion was held in abeyance while a record of relevant evidence was created.

C. Decision

The trial occupied eight days, concluding on March 22, 1996. Post trial briefing and oral argument was completed on May 6, 1996. This is the Court's decision on the evidence presented. For the following reasons I conclude that plaintiff has failed to establish facts entitling it to the relief it seeks. Specifically, I conclude that the best reading of the relevant language, under the legal test described below, is that Time Warner retained the right under amended Section 5.5 of the TWE Limited Partnership Agreement to increase its ownership stake in TBS; that it did not mislead U.S. WEST in that connection, and that its failure to disclose to U.S. WEST the so-called Hersch memorandum was neither intentional nor actionable in the circumstances; and[*11] finally that exercise of the legal right to increase its TBS stake, as contemplated by the agreement of merger, will not itself constitute a violation of the fiduciary duty of loyalty owed by TWI to TWE and its limited partner.

There are pending counterclaims against U.S. WEST that were tried simultaneously with the foregoing claims. I am not now, and will not for some time be, in a position to express a judgment on those claims. Therefore, concluding that there is not just reason for delay in doing so, I will direct that a final judgment be entered under Court of Chancery Rule 54(b), in a form to be agreed upon by the parties, dismissing plaintiffs' complaint with prejudice.

II.

A. Background: The Merger of Time Inc. and Warner Communications:

The pertinent background might begin with considerations leading to the merger of Time Inc. and Warner Communications, Corp. in early 1990 to form Time Warner, Inc. That merger originated in the strategic thinking of Gerald M. Levin, then Executive Vice President of Time, Inc. Mr. Levin's strategic vision was set forth in a memorandum dated August 11, 1987, to then Time, Inc. CEO Richard Munro, in which Levin stated:

I am now[*12] convinced that our primary long-term objective should be to bring about the strategic consolidation of Time Inc., Warner Communications, and TBS. The resulting company would be a complete, world-class entertainment and publishing giant with well in excess of a billion dollars of operating income.

* * *

This would be an operating company, not a financial construct, with sufficient internal cash generation to fuel new development. Indeed, the cross-section of businesses, particularly in entertainment, would provide growth opportunity across cable, CD's, home video and pay-per-view. The strength of the new company would be in its operating management and philosophy, its extraordinary distribution capabilities, and in its handling of a diverse array of talent.

(emphasis in original). Mr. Levin is now CEO of Time Warner and is the moving power behind the current proposed acquisitions of TBS by Time Warner.
Prior to the merger between Time and Warner, each had been a substantial shareholder of TBS. Following the merger TWI owed sufficient Class C Preferred Shares of TBS to approximately equal a 20% interest in TBS. Under certain agreements with other TBS shareholders, including Mr. R.E. "Ted" Turner, Tele-Communications Inc. ("TCI") and other cable company investors (the "TBS Shareholders Agreement"), Time Warner had and continues to have the right to acquire additional shares in TBS under certain circumstances. One such circumstance would occur if Ted Turner proposed to accept a bona fide offer from an unaffiliated party to purchase all of his shares. In that event the TBS Shareholders Agreement gives a right of first refusal to the Class C investors (a group of 29 cable companies including Time and Warner). A second aspect of the agreement involved the right to purchase shares pro rata from any of the other cable investors that wished to dispose of shares other than to a permitted transferee. In some circumstances, exercise by Time Warner of its rights under the TBS Shareholder Agreement would allow it to acquire control of TBS.

In addition, the parties cannot enter into agreements with respect to the disposition, voting or holding of any TBS stock except in certain limited circumstances; and the transfer of the Class C Preferred to any party other than the original cable company investors or their parents or subsidiaries would result in a conversion of those shares into Class B Common. Furthermore, Time and TCI agreed to work to achieve parity in their ownership of TBS shares and also agreed not to dispose of TBS shares without first offering those shares to the other.

B. Formation of TWE: The Time-Warner merger involved the distribution of substantial amounts of cash (in addition to stock) to the shareholders of Warner Communications and, as a consequence, following the merger, the resulting entity, Time Warner Inc., had an initial balance sheet burdened with substantial debt. Soon after the merger, Time Warner began to consider means to reduce its debt. It considered structuring a partnership through which Time Warner could sell minority interests in certain of its businesses, while forming international strategic alliances with technologically sophisticated parties.

In this connection, TWI began negotiating with C. Itoh & Co. (now known as "Itochu") and Toshiba Corp., two Japanese corporations, (together, the "Original Limited Partners") in late 1990. On October 29, 1991, Time Warner, and the Original Limited Partners signed the Time Warner Entertainment partnership agreement. The Original Limited Partners together contributed $1 billion to the partnership in exchange for a combined limited partnership interest of 12.5%. Time Warner contributed substantially all of its filmed entertainment, programming and cable assets to the Partnership. Among the assets Time Warner did not contribute, however, was any interest in TBS.

[n4] Among the TWI affiliates that signed the Partnership Agreement were: Home Box Office, Inc., Warner Bros., Inc., Warner Communications, Inc., Warner Cable Communications, Inc. The resulting limited partnership consisted of four general partners--American Television and Communications Corporation, Warner Communications, Inc., Warner Cable Communications Inc., and Time Warner Operations Inc.--all wholly owned subsidiaries of Time Warner--and two limited partners, Itochu and Toshiba Corp. American Television and Communications
Corporation and Warner Communications, Inc. served as the managing partners of TWE.

Because TBS included various programming and broadcasting assets similar to those that Time Warner was to contribute to the partnership, the Original Limited Partners had asked TWI to contribute its TBS shares to the partnership. Time Warner, however, declined to do so stating that under the TBS Shareholders Agreements, it could not transfer its TBS interests without risking the loss of valuable rights, i.e., potentially exposing its shares to the first refusal rights of other TBS investors. Alternatively, it was proposed that Time Warner agree to contribute TBS to TWE at fair market value in the event that Time Warner later acquired control of TBS. Although sympathetic to this arrangement as a business matter (it would make obvious sense to manage in the TWE structure any TBS assets acquired by TWI), Time Warner restated its concern that its consent to this request would potentially expose its TBS shares to claims that first refusal rights had been triggered. TWI was prepared to say that it would be its intention to contribute the TBS assets to TWE for fair value if it later did acquire control of TBS; however, it was unwilling to express that intention in the form of a binding legal obligation.

Not wholly content with such oral assurance, the attorney for the Original Limited Partners, Dennis Hersch, Esquire of Davis Polk & Wardwell, memorialized Time Warner's statement in a memorandum confirming that it was "the spirit of the parties" to follow the terms and conditions of an unsigned side letter outlining TWI's intent to offer TBS to TWE at a fair price if it were ever acquired. On October 29, 1991, Mr. Hersch sent this file memorandum to Mr. Robert Schumer of Paul, Weiss, Rifkind, Wharton & Garrison who served as lead counsel for Time Warner in the deal attaching the proposed side letter (together, the "Hersch Memorandum"). Upon receiving the Hersch Memorandum, Mr. Schumer sent a copy to Peter Haje, the general counsel of Time Warner. The memo, however, was not disclosed in SEC filings, to TBS shareholders or to U.S. WEST until it was produced in this lawsuit.

C. U.S. WEST Becomes a Partner. By 1992, Time Warner recognized that with a convergence in the communication and information/entertainment businesses TWE would benefit from expertise in telephony operations and consequently began talks with potential partners including Bell Atlantic, Ameritech, and eventually U.S. WEST.

Around the same time, the strategic planning group within U.S. WEST informally known as the "Cottage Group" projected that U.S. WEST, and telephone companies generally, would increasingly face new types and sources of competition, particularly from cable companies (whose broadband cable can carry information more efficiently than can the copper wires that historically comprise telephone networks). The Cottage Group came to the view that U.S. WEST should aim to become a provider of integrated communications, entertainment and information services through broadband wire and wireless networks worldwide. To achieve that goal, the Cottage Group recommended developing broadband networks outside U.S. WEST’s region, either in partnership with cable companies or by acquiring cable assets. The board approved this strategic goal. Pearre Williams, President of U.S. WEST’s Corporate Development Group, was therefore directed to contact cable operators to determine the feasibility of joint ventures to develop a broadband network ("full service network") that could supply telephony as well as other services.

The first contacts between U.S. WEST and Time Warner occurred in the Spring of 1992. Although open to the possibility of investing in TWE and cognizant of the increasing interrelations between the telecommunications and entertainment industries, U.S. WEST primarily expressed interest in participating in
some way in Time Warner’s substantial cable properties. Time Warner, however, was [*19] interested in admitting investors at the TWE level. Mr. Oded Aboodi, the chief negotiator for Time Warner, took the sensible view that for the partnership to succeed, the partners must have consistent economic interests across the different, but increasingly interrelated segments of TWE’s businesses. Mr. Aboodi explained that this joining of interests would permit the partnership flexibility by making less important to partners the financial terms of transactions between business centers within TWE. In addition, a partner with a cable only investment might, for example, act as a drag on efforts to grow all segments of TWE’s business and promote the best interests of TWE generally. Influenced also by its own long-term strategic objectives towards becoming a leading information, communication and entertainment company, U.S. WEST accepted TWI’s position that any U.S. WEST investment should be in all of TWE’s businesses.

US WEST retained Lehman Brothers, Inc., as its financial advisor in the negotiations. Lehman had advised the Original Limited Partners with respect to their investment in TWE and thus U.S. WEST sought to benefit from the understanding of the complex financial structure[*20] of TWE that Lehman gained during the 1991 transaction. Lehman, however, did not volunteer other information it had learned representing the Original Limited Partners in the 1991 transaction.

D. Negotiating the Non-Compete Provisions:
As in the negotiations leading up to the 1991 partnership agreement, the parties to these negotiations spent considerable time on the non-compete provisions, negotiating non-compete issues almost daily from December 1992 through May 1993. Time Warner and U.S. WEST initially disagreed over whether U.S. WEST would be bound by the non-competition provisions in the 1991 Partnership Agreement. Time Warner sought to use the 1991 Partnership Agreement with Toshiba and Itochu as a model for U.S. WEST’s admission into the partnership and tried at first to convince U.S. WEST to agree to the non-compete provisions in the 1991 agreement. But U.S. WEST wanted instead to negotiate for itself separately applicable, less restrictive non-competition provisions that would allow it the freedom to pursue investments outside the partnership in, other cable companies, programming companies, information services, international activities, telephone companies, and content[*21] activities. For example, in March 1993, U.S. WEST specifically proposed that it retain the freedom to invest in "content" outside of the TWE partnership provided that it gave a right of first opportunity to the Partnership. U.S. WEST wanted the freedom to make investment outside the partnership because of its limited management powers over the content (i.e., programming and entertainments) side of the business and its desire to retain the flexibility to respond to future opportunities. Time Warner insisted, however, that any deviation from the non-competition provisions in the 1991 agreement take the form of amendments to the 1991 Partnership Agreement and exceptions to those provisions that the parties negotiated.

US WEST acceded to Time Warner’s view that TWE be the primary vehicle through which the partners would exploit cable, filmed entertainment and programming opportunities. The final non-compete clause, therefore, contains no broad exception for it, and the negotiations concerning Section 5.5 more narrowly focused on the scope of U.S. WEST’s exceptions to the basic restraint of Section 5.5(a). The parties, however, did not generally discuss the meaning or scope of[*22] the exceptions for Time Warner incorporated in the original Partnership Agreement and continued in the 1993 amendment to Section 5.5. Consequently, mention of Time Warner’s
rights in TBS during the negotiations was limited.

Nevertheless, U.S. WEST was made aware of the TBS stake and of the TBS stockholders agreements. It was told both that TWI might "monetize" that stake (i.e., sell it or trade it for another asset) and that in any case TWI thought it should maintain the financial capacity to exercise all of its rights under the TBS Shareholders Agreement, in the event those rights were triggered. The parties, however, did not explicitly discuss whether Time Warner had the right under the partnership agreement to increase its interest in TBS without the consent of the limited partners. Furthermore, TWI made no representations concerning its present intention or future plans concerning its TBS stake upon which a reasonable party could rely. Its plans were not fixed and it made its desire for flexibility explicit.

The parties' negotiations over competition focused primarily on U.S. WEST's content related activities outside the partnership. The resulting noncompete provisions granted U.S. WEST investment opportunities in filmed entertainment, programming and cable that would have been unavailable under the 1991 Agreement, and included U.S. WEST's own Schedule of Restricted Businesses exempted from the non-compete. As in the case of the Original Limited Partners under the 1991 agreement, U.S. WEST also had the right after four years to terminate the non-compete with respect to Time Warner's content businesses. But it was agreed that if U.S. WEST terminated the non-compete in this manner, it would then have to sacrifice all board representation, all veto rights, and all rights to information concerning those businesses.

During the negotiations, Time Warner had expressed some concern about U.S. WEST using the investments listed on U.S. WEST's Schedule of Restricted Business to compete in new lines of businesses and thereby circumvent the non-compete provision of Section 5.5(a). In this regard, Time Warner representatives asserted that U.S. WEST should not be able to use scheduled exception such as Telewest, a UK company in which U.S. WEST had a substantial minority interest at the time, to acquire a movie studio (Paramount was mentioned at that time) that would compete with the TWE's filmed entertainment business. The parties resolved this issue by amending Section 5.5(b)(iii) to specify that the partners could not encourage companies in which they had an interest to engage in competitive activity.

The deal closed in September 1993. Under the Admission Agreement, U.S. WEST acquired a 25.51% partnership interest in TWE in exchange for cash and a note together valued at $2.5 billion. U.S. WEST was also granted rights under the agreement to co-manage TWE's cable systems as the parties had, in fact, contemplated from the outset. The parties, however, agreed that Time Warner would have the responsibility for management of the content (i.e., filmed entertainment and programming) businesses, with U.S. WEST receiving only limited management rights over content: representation on the TWE board of directors, right to veto extraordinary transactions, and rights to information concerning the content business.

E. Restructuring the Partnership. In November 1994, Time Warner began to reconsider its original strategy of consolidating its cable, content, and programming assets under separate equity ownership in TWE. Time Warner's senior management concluded that the partnership's content businesses and Time Warner's publishing and music businesses were converging faster than the content, programming and cable grouping in the partnership, and that the complex corporate and capital structure of TWI was having an
adverse effect on the market price of Time Warner stock. Time Warner therefore initiated a "simplification" process involving possible restructuring of the partnership. In late 1994, pursuant to this attempt to simplify Time Warner's operating and capital structure, TWI discussed with both U.S. WEST and the Original Limited Partners the possibility of exchanging their partnership interest for stock in Time Warner. The Original Limited Partners agreed to exchange their limited partnership stake for Time Warner convertible preferred stock.

With respect to U.S. WEST, in early 1995, Time Warner expressed an interest in restructuring the partners' respective investments in the partnership to create a self-financing "cable only" telecommunications entity separate from the content and programming assets of the partnership. This is essentially what U.S. WEST had originally sought. These discussions included the possibility of U.S. WEST trading its "content" investment for a greater interest in a free standing cable entity. By the summer of 1995, the discussions were at an impasse caused by an inability to resolve ownership and management control issues as well as continuing differences on the intrinsic valuation of various partnership assets. In particular, Time Warner would not accede to U.S. WEST's desire for control over TWE's cable assets unless U.S. WEST agreed to pay a control premium. These discussions have not yielded agreement.

F. TWI's Planned Acquisition of TBS: In August 1995, TWI's CEO, Gerald Levin, met with TBS' CEO Ted Turner and introduced the subject of merging Time Warner and TBS. Mr. Turner was somewhat surprised by this turn of events, principally because Time Warner had recently considered "monetizing" its TBS asset by either selling that interest or exchanging it for TBS assets. Moreover, on several previous occasions in which he approached the management of Time, Inc. and later Time Warner about the possibility of a merger, Turner found little interest because of, in his view, their reluctance to accept his potential influence as large personal shareholder in the merged entity. [**27]**

Time Warner first informed U.S. WEST of a proposed TWI merger with TBS on August 26, 1995. After several discussions between U.S. WEST and Time Warner representatives concerning the merger and during which U.S. WEST did not articulate an objection to the merger, U.S. WEST formally advised Time Warner in writing on September 7, 1995 that, in its view, U.S. WEST's consent was necessary before TWI could proceed with the proposed transaction. On September 22, 1995, Time Warner and TBS publicly announced their agreement to merge and U.S. WEST filed this suit to enjoin the merger on that same day.

III.

Legal Principles

At their core the legal aspects of this dispute concern the effect of Section 5.5 of the 1991 TWE Partnership Agreement as amended by the 1993 Admission Agreement. These contracts were expertly and exhaustively negotiated and documented. The subject of the parties rights to engage in business activities that compete with the partnership's businesses or to own interests in ventures that compete with TWE was addressed in Section 5.5 in 1991 when the partnership was [*28]** formed and in 1993 when U.S. WEST made its large investment in TWE. n5 All that needs to be done to resolve the principal dispute in this suit is to distill the legal meaning of Section 5.5 as
amended and apply that meaning to the facts presented. The task, thus stated, deceptively appears simple. In fact, determining the legal meaning of amended Section 5.5, insofar as it may apply to the planned TBS acquisition is not, in my opinion, a simple matter.

n5 See Admission Agreement § 11.

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In construing the meaning of written contracts, the court's first obligation to the parties is to determine the nature and scope of the contractual rights and obligations they created and to enforce those rights and obligations in accordance with law. n6 Of course, the nature and scope of the rights and obligations created will often be the primary issue to resolve. The court's ultimate guide in determining those legal entitlements is to attempt to fulfill, to the extent possible, the reasonable shared expectations of the parties at the time they contracted. n7 With this in mind, I apply the following principles or rules of contract construction that courts have traditionally employed in construing written contracts.

n6 "The "in accordance with law" condition is meant to incorporate all of the law dealing with defenses and remedies that a court will be obligated to take into account in enforcing a contract.

n7 See CORBIN ON CONTRACTS § 1 (1960); Bell Atlantic Meridian Systems v. Octel Communications Corp., Del.Ch., C.A. No. 14348, Allen, C. (Nov. 28, 1995); cf. RESTATEMENT (SECOND) OF

CONTRACTS § 201 cmt. c (1981) ("The objective of interpretation in the general law of contracts is to carry out the understanding of the parties . . . ."); WILLISTON ON CONTRACTS § 601 (1961) ("[The] primary function of the court is the ascertainment of the intention of the parties.").

The primary rule of construction is this: where the parties have created an unambiguous integrated written statement of their contract, the language of that contract (not as subjectively understood by either party but) as understood by a hypothetical reasonable third party will control. n8 In essence, this is an assessment of whether the reasonable expectations of the parties are convincingly established by the words of the contract standing alone—the language being so unequivocal that no reasonable person could have expectations inconsistent with such language. This first principle might be referred to as the clear meaning rule. n9 I apply this principle in Part A below.


n9 The clear meaning rule helps deal with the problem of unforeseen circumstances. Since it applies without regard to actual subjective intent it makes unforeseen circumstances irrelevant. Moreover, it also creates incentives for the parties themselves to contract with respect to unforeseen future conditions. It will often be rational for
contracting parties, mindful of their very imperfect information about the future, to draft broad procedural or substantive default terms designed to govern the parties relationship under unforeseen circumstances. When clearly set forth, such mechanisms are enforceable under the clear meaning rule.

[*31]

The foregoing first principle of contract interpretation will not resolve all cases, or indeed any of the most difficult cases, and it does not resolve this case. A second principle of the law of contract holds that where the language of a written integration is susceptible to more than one reasonable interpretation, the court will consider proffered admissible evidence bearing upon the objective circumstances relating to the background of the contract. n10 Such evidence may include statements made during the course of the negotiation, courses of prior dealings between the parties, and practices in the relevant trade or industry. This second principle of contract interpretation is frequently called the parol evidence rule.

n10 See Klair v. Reese, Del.Supr., 531 A.2d 219, 223 (1987); Bell Atlantic Meridian Systems v. Octel Communications Corp., Del.Ch., C.A. No. 14348. Allen, C. (Nov. 28, 1995). In some cases, determining whether a contract is susceptible to more than one interpretation requires an understanding of the context and business circumstances under which the language was negotiated; seemingly unequivocal language may become ambiguous when considered in conjunction with the context in which the negotiation and contracting occurred. A preliminary consideration of extrinsic evidence may be necessary to determine whether this sort of hidden or latent ambiguity exists. See Bell Atlantic at n.5; WILLISTON ON CONTRACTS § 601 (1961) (observing that courts "frequently admit extrinsic evidence provisionally, not for the purpose of 'varying or contradicting' the writing, but to determine the fact that it is indeed ambiguous.").

[*32]

These extrinsic sources of contextual information may permit a court to ascribe a single "correct" or single "objectively reasonable" meaning to a contract term that appears on its face capable of two or more inconsistent interpretations. That is, a court may conclude that, given the extrinsic evidence, only one meaning is objectively reasonable in the circumstances of this negotiation. Thus, for example, a hypothetical contract may be identical in material respects to a series of earlier contracts between the same parties in which performance of a particular type was tendered and accepted. If the operative language in all of those contracts was and is ambiguous, that prior history will demonstrate what an (objectively) reasonable party in the position of either bargainer would have understood the nature of the contractual rights and duties to be. It is that reasonable understanding that a court will enforce.

The parol evidence rule guides a court with respect to the materials from which it will define the nature and scope of contractual obligations, but it does not specify in what way the court will use those materials in making such determinations. In the example above, the inference[*33] from the prior course of dealing is so powerful that the logical operation employed in determining what an hypothetical bargainer would understand the ambiguous
words to mean receives little attention. But if, given the nature of the extrinsic evidence, such a is not quite so obvious (as of course will often be the case), what is the process through which a court determines the existence and scope of legal rights and duties where contract language is ambiguous? n11 The following third principle of contract law structures that inquiry: Only an objectively reasonable interpretation that is in fact held by one side of the negotiation and which the other side knew or had reason to know that the first party held can be enforced as a contractual duty. n12 This principle is capable of resolving disputes arising from ambiguous contract language because it is logically impossible for a contracting party, operating in good faith, both to have a subjective interpretation of ambiguous language different from that of her counterparty and to know of her counterparty's differing interpretation. n13

n11 I mention "the existence of legal rights and duties...." in order to leave open the possibility that parties have failed to create any contract rights and duties despite their parallel intentions to do so. See RESTATEMENT (SECOND) OF CONTRACTS 2d. § 201(3) & cmt. d (1981); CORBIN ON CONTRACTS § 538 (1960).


n13 Note that an alternative way to conceptualize this approach to refining legal rights from completed contractual negotiations that conclude in ambiguous written undertakings is to see it as a species of obligation of good faith to a contracting party. It also shows that the legal categories "contract" and "tort" while largely distinct are not completely so. See also note 23 infra for a further example of such overlap.

Thus, while the subjective understanding of a contracting party is not ordinarily a relevant datum in determining the existence and scope of contractual obligation (such obligations being determined under an "objective" standard), where ambiguity in contract language is not easily resolvable by extrinsic evidence, it may be necessary for the court, in considering alternative reasonable interpretations of contract language, to resort to evidence[35] of what one side in fact believed the obligation to be, coupled with evidence showing that the party knew or should have known of such belief. This last principle of contract construction might be called the forthright negotiator principle.

Finally, if extrinsic evidence does not make it clear which alternative interpretation of ambiguous contract language was intended by the parties to define their respective rights and duties, and neither party knew or had reason to know the reasonable, differing interpretation held by its counterparty then, inescapably, the parties have failed to contract on the subject and no contractual rights and duties have been created. See RESTATEMENT (SECOND) CONTRACTS 2d § 201(3) & cmt. d (1981); CORBIN ON CONTRACTS § 538 (1960). What rights and duties may arise in such circumstance (especially where there has been some performance) may present a complex
question of the law of tort or of restitution, but the remedies will not strictly speaking be contractual. The problem of these rights and remedies happily need be addressed here as I conclude that the parties did entered into an enforceable agreement in amended Section 5.5(b).

A. Analysis Under the[*36] Clear Meaning Rule:

I thus turn first to the language of the amended Partnership Agreement to determine whether, on its face, the language of Section 5.5 thereof would be violated by TWI's contemplated acquisition of a controlling interest in TBS.

Admitting U.S. WEST into the TWE Partnership required extensive restructuring of the partnership. n14 As discussed above, among these changes was a restatement and amendment to existing Section 5.5. Subsection (a) of that section sets forth a basic non-competition obligation, subject to an elaborate exception that was extensively negotiated both between the Original Limited Partners and Time Warner in 1991 and between U.S. WEST and Time Warner in 1993.

The core of amended Section 5.5 is set forth in subsection (a), which provides a broad restriction against engaging in a "Restricted Business".

(a) "Except as otherwise provided . . . [every party to this agreement] . . . (a "Restricted Party") shall not (and such party shall cause its Controlled Affiliates not to), except as otherwise described below, engage, directly or indirectly (whether by operation, investment or otherwise), in the Restricted Territory (as defined below) in any Co-Managed Business or any Programming and Filmed Entertainment Business (a "Restricted Business")

n15 All emphasis provided to quoted language from agreements has been added, unless otherwise noted.

n16 A "Co-Managed Business" is defined essentially as the cable business.

n14 This was done in part to minimize the areas of TWE business that would be subject to the costly regulatory regime imposed upon former Bell Operating Companies by a consent order entered by the United States District Court for the District of Columbia. That order, subsequently mooted by legislation, extended to certain telecommunication businesses in which U.S. WEST was engaged.

Thus subsection (a) precludes TWI as a Restricted Party from "engaging . . . indirectly . . . by investment . . . in any programming or filmed entertainment business . . . except as provided below." Subsection (b) then provides[*38] a lengthy exception to the prohibition of (a). It provides in part:

(b) Nothing contained in this Section 5.5 shall prohibit or otherwise restrict a Restricted Party (or its Controlled Affiliates) from:

***
(iii) owning or conducting any Restricted Business or Businesses disclosed on Schedule 5.5 (or any interest therein) or owning an interest in a Restricted Business disclosed on Schedule 5.5 or an entity that owns or conducts any Restricted Business so disclosed; provided that if such Restricted Party Controls the entity that owns or conducts such Restricted Business, such Restricted Party shall cause such entity not to compete with the Partnership or TWE Japan in any additional lines of Restricted Business, and if such Restricted Party does not Control the entity that owns or conducts such Restricted Business, such Restricted Party shall not (and shall cause its Controlled Affiliates not to) encourage or promote such entity's competing with the Partnership or TWE Japan in any additional lines of Restricted Business.

Schedule 5.5, referred to in Section 5.5(b), is an appendix to the 1991 Partnership Agreement entitled "Time Warner Inc. Competing Businesses Not Required To Be Transferred to Partnership[.]") The ten numbered paragraphs set forth therein identify either assets or activities of TWI. The first of these numbered paragraph mentions "any of the Assets or Rights of TWI and its Subsidiaries listed on Schedule 3.1-C and 3.1-D[.]") Schedule 3.1-C to the 1991 Partnership Agreement, in turn, is entitled "TWI Excluded Assets" and provides in relevant part as follows:

Notwithstanding anything to the contrary contained in Schedule 3.1-A, any other Schedule or the Agreement, the parties expressly understand and agree that there shall be excluded from the Assets to be contributed to the Partnership the following (collectively the "TWI Excluded Assets") . . . .

2. Rights of TWI and its Subsidiaries in Turner Broadcasting System, Inc. ("TBS") and any Rights in any document or agreement governing the parties' ownership of TBS or other rights among certain stockholders of TBS; . . . .

It will be recalled that among the rights in TBS understood by everyone to be held by TWI were rights under the TBS Shareholders Agreement to acquire additional TBS stock, which might allow Time Warner to acquire a controlling interest in TBS under certain circumstances.

Thus, the central question is framed as follows: do the exceptions contained in Schedules 5.5 and 3.1-C of the 1991 agreement and incorporated into amended Section 5.5 of the Admission Agreement authorize TWI to acquire a controlling interest in TBS despite the prohibitions of Section 5.5(a)? Each party asserts that the language of Section 5.5 more or less straight-forwardly supports its position.

Time Warner's interpretation: TWI admits that TBS engages in the programming and filmed entertainment business, it is a Restricted Business as defined in Section 5.5(a). But TWI explains that Section 5.5(b)(iii) explicitly permits it to own or conduct "any Restricted Business disclosed on Schedule 5.5 . . . . or "an interest in a Restricted Business disclosed on Schedule 5.5 . . . ." Since, it says, TBS "is disclosed on Schedule 5.5" and ownership of 100% of TBS is ownership of "an" interest or "any" interest in TBS, the clear meaning rule dictates, in its view, that U.S. WEST's contract claim must fail.

Does Schedule 5.5 "disclose" TBS as a Restricted Business? That schedule is quoted above. Literally, it discloses (through its reference to Schedule 3.1-C) "excluded assets" including "Rights . . . in [TBS][.]") TWI, however, asserts that "Rights. . . In [TBS]" must be read to include TBS itself based on the following logic: "Rights in any person" are defined in the Schedule to mean "the assets of such Person"; n17 "assets" are, in turn defined
in Schedule 3.1-A to mean "assets, rights and businesses"; so "Rights . . . in TBS" excluded from the noncompete should therefore be read to include all of the "assets, rights and businesses" of TBS. Thus Time Warner asserts that a literal and technical reading of Section 5.5 defines TBS as a Restricted Business disclosed on Schedule 3.1-C in which it may own "an" interest (unrestricted in size) or "any" interest.

n17 Schedule 3.1-C states "Rights in any Person shall be deemed to mean the assets of such Person and the definition of TWI Excluded Assets shall specifically include such Assets . . . ."

Against this argument stands (1) the inference that the extreme indirection that such drafting represents[*42] makes the interpretation sought appear somewhat strained (I note for example the absence in Section 5.5 as drafted of a provision such as was contained in a preliminary draft of the 1991 agreement which specifically acknowledges the power of a partner to increase an investment in a scheduled company), n18 and (2) the fact that the basic function of the schedule is simply to identify assets that were owned by TWI but were to be excluded from the assets contributed to the partnership. In light of the limited function of the schedule, it seems somewhat less plausible that the parties would deal with scope of the 5.5(a) restriction by such indirection as TWI's interpretation comprehends. A more plausible explanation for the breadth of the "Rights" definition in Schedule 3.1-C, in my reading of it, is to assure that U.S. WEST could not claim that assets subject to TWI's control through scheduled "Rights" were required to be contributed to TWE (or were subject to the restriction of Section 5.5(a)) even though the "Rights" through which those assets were controlled were excluded from contribution, i.e., "belt and suspenders" drafting.

n18 The earliest 1990 drafts of the noncompetition provisions most clearly express the shared understanding that the partners were not required to obtain the consent of the other partners to increase/decrease their interests in a scheduled exception. They expressly permit a partner to "increase its investment in any Person in which it has an investment. . . ." JX-9 at FS 1321, JX-16 at T100374. In later drafts this language dropped out when Section 5.5(b) was amended to permit a partner to "<own[] or conduct[]> any Competing Business or Businesses <disclosed> on Schedule 5.5 <(or any) interest therein>)." 

[*43]

Thus I cannot conclude that defendants reading of amended Section 5.5 is the sole reasonable interpretation of this language, even though in a technical sense I cannot exclude that interpretation as unreasonable.

US WEST's interpretation: U.S. WEST on the other hand asserts that the words of the amended Section 5.5(b) plainly show an intent of the parties to limit Time Warner to the interest it held in 'TBS as of the date of U.S. WEST's admission into the partnership.

Plaintiff supports this position by presenting a technical interpretation of subsection 5.5(b)(iii) that hinges first upon an alleged distinction between "Restricted Business" activity and a competitive "entity" and secondarily upon the supposed difference in the meaning of "an" interest and of "any" interest. Recall subsection 5.5(b)(iii):
(b) Nothing contained in this Section 5.5 shall prohibit or otherwise restrict a Restricted Party (or its Controlled Affiliates) from:

(iii) [1] owning or conducting any Restricted Business . . . . disclosed on Schedule 5.5 (or any interest therein) or [2] owning an interest in [a] a Restricted Business disclosed on Schedule 5.5 or [b] an[*44] entity that owns or conducts any Restricted Business so disclosed; . . . .

Notice that this provision may arguably be read to draw a distinction between "Restricted Business" and "entity" even though both are treated the same under the clause. Note also that both aspects of clause [2] are modified by the limiting adjective "an" rather than the limiting adjective "any" used in clause [1]. These distinctions are the raw material of U.S. WEST's argument.

US WEST argues that Section 5.5 differentiates between "Restricted Business[es]," meaning business activities, and owning interests in "entities" that themselves conduct those restricted business activities. n19 Under the reading of Section 5.5 that it advances, while a party may own any interest in a restricted business activity, it may only hold an interest (which U.S. WEST reads as meaning the specific interest identified on Schedule 5.5) in an entity that owns or conduct a restricted business activity. U.S. WEST argues that because TBS is an "entity," Time Warner is only permitted to own an, and not any, interest therein; that specific interest, in turn, is defined by the partnership agreement as[*45] the interest that Time Warner held as of the effective date of U.S. WEST's admission to the partnership. U.S. WEST says that it is necessary to adopt its reading of Section 5.5 (b)(iii) to avoid redundancy in interpreting the words of that provision.

n19 Schedule 5.5, according to U.S. WEST, exhibits this dichotomy, listing both business activities (e.g., "production and telecast . . . of video and audio devices . . .") and entities (e.g., Boston Ventures, in which Time Warner had "Rights").

US WEST suggests that the distinction between the right to own "an" interest in an entity and the right to own "any" interest in a Restricted Business reflects the parties heightened sensitivity to potential competition from entities in which the partners held an interest. U.S. WEST would have the court believe that in excepting interests in certain entities from the noncompete provisions, the parties determined that those specific interests (held as of the effective date) would not place intolerable burdens on[*46] TWE's businesses as might a controlling interest in those entities; they therefore negotiated narrow exclusions for those interests. Continuing with its supposition, it asserts that the decision to except certain restricted business activities from the noncompete, in contrast, reflects the parties' general consent to competition from those activities and their determination that conduct of those activities outside the partnership would not significantly harm TWE's interests. Therefore, according to U.S. WEST, having already accepted competition from those business activities listed on Schedule 5.5, the partners could hold any interest in those Restricted Businesses and not only the interest held as of the effective date.

There is virtually nothing in the language of amended Section 5.5 that makes this a convincing reading of that provision. Nor is there (and since I here am treating the clear meaning analysis of the contract words, I jump ahead of myself in noting) any substantial evidentiary support in the record for this account of the contract words.
Under a clear meaning interpretation, Section 5.5 (b)(iii) [1] and [2] inescapably contain redundancy. While redundancy[*47] is sought to be avoided in interpreting contracts, this principle of construction does not go so far as to counsel the creation of contract meaning for which there is little or no support in order to avoid redundancy. "Restricted Business," as defined in Section 5.5(a), includes direct or indirect ownership and encompasses ownership [of operating assets] or investment. Section 5.5 does not distinguish between these alternative forms of competition with TWE's assets. That Section uses the broadly defined "Restricted Business" term somewhat indiscriminately in both clause [1] and clause [2] and does not reflect the distinction that U.S. WEST relies upon.

Concluding as I do that amended Section 5.5 (b)(iii) unavoidable must be read to include a certain degree of redundancy, I sought from the record an understanding of how that could occur. A comparison of amended Section 5.5 with its predecessor reveals the linguistic changes that produced that redundancy. That history is significant only as background and I record it summarily in an extended footnote. n20

n20 The original agreement did not employ the term "Restricted Business" but used two terms "Competing Business" and "Competing Party". Generally the predecessor provision (while in effect and within the relevant territory) prohibited any party from engaging directly or indirectly "in any business or businesses then being conducted, directly or indirectly, by the Partnership (a Competing Business") or "except through the Partnership . . . [to] become interested, directly or indirectly, in any Person engaged, directly or indirectly, in a Competing Business ... (Competing Person"), as a partner .... or any other capacity of ownership or control." The 1991 contract also had scheduled exceptions from the general noncompete provisions. Subsection (b)(ii) of the 1991 agreement contains language parallel to that presently under consideration. Specifically, the restrictions against competition would not prevent any party from:

(ii) [I] owning or conducting any Competing Business or Businesses disclosed on Section 5.5 (or any interest therein) or [2] owning an interest in a Competing Person [a] disclosed on Schedule 5.5 or [b] that owns or conducts any Competing Business so disclosed.

The structure of this predecessor provision contains no redundancy. Clause [1] addresses businesses in the sense of activities or assets used to engage in such activities; the parenthetical ("or interest therein") is helpful to cover unusual forms of participation, such cases as a partner acting as a lessor for a business activity disclosed on Schedule 5.5. Clause [2] addresses ownership, not of assets used in activities, but of interests in legal persons that are either [a] disclosed in Schedule 5.5 or [b] themselves own assets used in a scheduled competing activity. Thus each clause of the predecessor provision adds meaning to the provision. (Even if they do not answer the fundamental question of a right to increase ownership interests under clause (2a)).

By introducing in Section 5.5(a) the single concept of "Restricted Business," the amended structure of Section 5.5(b)(iii) was rendered less coherent than the structure of its predecessor Section 5.5(b)(ii) of the 1991 Partnership Agreement. Clause [1] of that subsection, by allowing a partner to own or conduct a "Restricted Businesses" or "(any interest therein)[,]" seems to moot at least clause [2][a] (which allows ownership of
"an interest") if not also [2][b]. U.S. WEST's argument that clause [1] refers to a majority interest and clause [2][a] refers to a minority interest does not find convincing support in the language of the 1993 provision. Although the "owning or conducting" language in clause [1] suggest majority ownership, that clause also includes the parenthetical "(or any interest therein)[,]" suggesting the right to both majority and minority interest. More significantly, the plain language of clause [2] does not indicate that "an interest" refers only to a minority interest.

[*48]

US WEST also advances a separate, less technical and more forceful argument in favor of its reading of Section 5.5. It asserts that by the very nature of Schedules 5.5 and 3.1-C, the "rights in" TBS excepted from the noncompete are logically limited to those rights held as of the effective date of the partnership. Schedule 3.1-C, the schedule from which TWI'S "rights in" TBS are ultimately incorporated into Section 5.5(b)(iii), is a list of Time Warner's excluded assets, i.e., assets that Time Warner owned on the effective date but were not required to contribute to the partnership. As such, U.S. WEST argues, the schedule should be reasonably read to include only those rights that Time Warner actually held as of the effective date; Time Warner would not have logically included on a schedule of excluded assets an interest in TBS that it did not then own.

This argument has certain force, but it is not sufficiently compelling to render unreasonable the technical "rights definition" argument advanced by Time Warner. It does, however, serve to make more clear the conclusion stated in the next paragraph.

No single clear meaning: Thus, with respect to the core question whether [*49]Section 5.5(b)(iii) permits TWI to increase its holdings in TBS beyond that which it held at closing of the Admission Agreement, in my opinion, based upon the written words of the contract only, neither interpretation of the relevant contract language proffered by the parties presents a convincing case of being the single reasonable interpretation of that language. Time Warner's interpretation predicated upon the definition of "rights" in the relevant schedule and the retention of its rights in under the TBS Shareholders Agreement, appears to represent the better technical interpretation of the legal meaning of the amended partnership agreement. That reading is technically sound, but is cast into some doubt by its notable indirectness and by U.S. WEST's strong over-riding point that such an indirect treatment of this subject is logically flawed. Thus, I cannot conclude that either interpretation presents a clear legal meaning defining legal rights and obligations. In these circumstances, in order to achieve a sound adjudication of respective rights and obligations, I turn to review of the evidence illuminating the evolution of the amended provision. n21 I do so however acknowledging[*50] that defendant has offered the better technical interpretation of the relevant provisions.

n21 For this reason, defendants' motion for judgment on the pleading which was reserved prior to trial is now denied.

B. Reading the Amended Agreement in Context

We must therefore recur to a further level of analysis, one that considers the parties dealings during the negotiations and other relevant surrounding circumstances. Considering that
extrinsic evidence, I then must determine the reasonable expectations of the parties, applying the principle referred to above as the forthright negotiator principle in order to do so. In the presence of alternative reasonable interpretations of contract language, that principle directs us to examine what the parties knew or reasonably should have known about the interpretation that the other party gave to the problematic language.

The surest conclusions under this principle follows from a four step analysis. First, it is necessary to determine what one party (call it seller) [*51] to the ambiguous contract reasonably understood a term to mean. Second, it is necessary to answer the question whether the other party (call it buyer) knew or should have known of seller's reasonable understanding of seller's rights or obligations under the contract. If one concludes that buyer did know (or had good reason to know) of seller's understanding, the conditions for establishing a contract right have been established. But as a check on that analysis it will be helpful to go through the obverse process. That is to ask third, what in fact was buyer's understanding of the relevant rights and obligations captured by the ambiguous language, and fourth, whether seller knew or had reason to know of buyer's understanding. If the analysis is sound these two path's will, of course, lead to consistent conclusions.

1. Time Warner's reasonable understanding of the meaning of amended Section 5.5 with respect to TBS: Determining what TWI in fact understood about the nature of the rights and responsibilities agreed to in amended Section 5.5 with respect to its interest in TBS is not difficult on this record. The record is essentially uncontradicted. Prior to the amendment of Section 5.5[*52] the record disclose that the TWE partners all understood that Section 5.5 did not prohibit them from increasing or decreasing their interests in the scheduled exceptions. Retaining the flexibility to increase or decrease interests in excepted businesses was of particular concern to the Original Limited Partners. Both Toshiba Corp. and Itochu are large multi-national conglomerates with diverse business interests that may have to support other firms within their keiretsu (network of corporations in different industries interrelated by cross ownership of stock and by reciprocal commercial relations) with additional capital infusions. Time Warner was willing to accommodate this concern, Tr. at 1061 (Mr. Aboodi), and the parties more generally understood that the 1991 Agreement permitted increased investments in scheduled activities or entities. Hersch Dep. at 101. With respect to the TBS interest specifically, TWI certainly understood that the Section 5.5(b) of the 1991 Agreement allowed it to increase its proportionate ownership interest in TBS. That understanding was shared by the other parties, Hersch Dep. at 105-06, 108-109, and was evidenced in the Hersch memorandum. n22

n22 A different interpretation of the meaning of the existence of the Hersch Memorandum might be that it represented the advance consent of the Original Limited Partners to an acquisition of control of TBS which (on that interpretation) might otherwise be seen as violative of Section 5.5 (a)'s non-compete proscription. But upon consideration this interpretation it is not sustainable. The Hersch memorandum was created unilaterally by the lawyer for the Original Limited Partners to provide comfort to his clients in the presence of a non-binding expression of present intention, and not by TWI lawyers as would be expected if the parties viewed the underlying understanding as being an advance consent by the Original Limited Partners. Most importantly neither the memorandum nor the earlier unsigned side
letter expressed a consent by the limited partners.

[*53]

There was very little, if anything, that occurred in the 1992-93 negotiations that might suggest any change in TWI's rights and duties under Section 5.5. The amended terms of Section 5.5 (b) did not modify the language of Schedules 5.5 or 3.1-C, or amend the terms of Section 5.5 in a way that would lead a reasonable person to conclude that any change in the effect of Section 5.5 on TWI's TBS investment was intended or had been effected; recall that the impact of the non-compete on TWI was not the focus of the 1993 negotiations. I therefore conclude that TWI's proffered understanding of the nature and scope of the rights and obligations created by Section 5.5, viz. partners may increase or decrease their interests in a scheduled exception, is well established in the evidence.

2. US WEST knew or should reasonably have known that TWI reasonably believed itself entitled to increase its TBS stake. I base this critical conclusion on the following. First, and most importantly, U.S. WEST knew that Section 5.5 also excepted from the non-compete rights possessed by TWI under the Shareholder Agreements to acquire additional stock in TBS (and that exercise of those rights could, under[*54] some set of circumstances, cause TWI to control TBS). In the absence of clear language to the contrary, it is not reasonable in the circumstances to conclude that the holder of a retained right was in effect agreeing that he could only exercise that right with another's concurrence.

Second, Time Warner senior executives told U.S. WEST that TWI had to maintain sufficient financing flexibility to enable it to quickly exercise rights under the TBS Shareholders Agreement if necessary.

Third, Time Warner's representatives told U.S. WEST that any TBS assets that TWI may come to control, which were within the scope of TWE's businesses, would be offered to TWE. Tr. (Aboodi) 1074; Tr. (Williams) 40. Thus, in my view, the most reasonable interpretation of these conversations reads them as most consistent with TWI having the legal power to increase its stake in TBS without prior approval of U.S. WEST.

Fourth, I note that in negotiating its admission to the on-going TWE partnership U.S. WEST did not discuss or negotiate in any detail the effect of Section 5.5 on Time Warner. Rather, all of the substantial negotiations on that subject related to U.S. WEST's effort to create rights or mechanisms [*55] that would allow it to engage in activities that might have fallen under a general non-competition provision. Where a party is negotiating the terms upon which it seeks admission to an ongoing partnership, in my opinion, it will reasonably make an affirmative effort to understand the interpretations of the existing partners of ambiguous terms in the Partnership Agreement that are material to it and not the subject present negotiation. Such a new partner should, absent deliberate manipulation and in the presence of partnership terms whose legal meaning is not entirely clear, be held to know that which a reasonable investigation would show concerning the accepted understanding of provisions governing the partnership. n23

n23 In support of this proposition I cite as a close analogy Section 154 of the RESTATEMENT (SECOND) CONTRACTS, which reads as follows:

§ 154. When a Pasty Bears the Risk of a Mistake. A party bears the risk of a mistake
when ... (b) he is aware, at the time the contract is made, that he has only limited knowledge with respect to the facts to which the mistake relates but treats his limited knowledge as sufficient.

[*56]

The RESTATEMENT broadly defines "mistake" to mean false belief of fact, and "fact" in turn includes all existing facts. Notably, an Introductory Note to the Section on "Mistake" indicates that "an important subcategory of such mistakes is mistake as to expression, in which the mistake relates to the contents or effect of a writing that expresses an agreement." (emphasis added).

Here, if in fact U.S. WEST did not initially comprehend that the existing partners understood Section 5.5 to permit TWI to increase its TBS stake, it could have easily asked any original partner about the power of TWI to increase its TBS stake. If it had done so, it undoubtedly would have learned the view of those parties. n24

n24 With respect to the fact that the Hersch Memorandum was not delivered to U.S. WEST counsel during the negotiations, see p. 56 below.

In light of these factors I conclude that U.S. WEST in fact knew or at least should reasonably have known of Time Warner's understanding that Section 5.5(b) [*57] enabled it to increase its stake in TBS beyond that held at closing of the Admission Agreement without the prior approval of the limited partners of TWE.

3. Assuming in the alternative that U.S. WEST believed that Section 5.5(a) precluded TWI from increasing its TBS stake: Turning then to the "buyers" side of the analysis of what the contracting parties knew or should have known about the counterparty's understanding, I ask, third, what in fact was U.S. WEST's own understanding of TWI's right to increase its ownership of TBS? I conclude above that U.S. WEST knew or should have known of TWI's understanding. The "should have known" aspect of that determination leaves some room logically for the possibility that the responsible corporate officers of U.S. WEST in fact believed that TWI had no right to increase its TBS stake without the concurrence of TWE limited partners, because TBS was a Restricted Business. Did U.S. WEST in fact so believe? The balance of credible evidence suggests that it did not.

The factors recited above suggests that U.S. WEST at least should have known of TWI's view of its rights with respect to TBS and that it did not care much about the issue in all events. [*58] Why would U.S. WEST not care very much? To appreciate why, it is perhaps well to have in mind that a change in any scheduled (competing) business could be of two types: first, a competing firm may increase its competitive activity by, for example, initiating new lines of products or new channels of distribution; or second, a partner might increase its ownership stake in a scheduled competing business, without effecting the competing business' actual level of effective competition against TWE.

Section 5.5 was designed in part to protect TWE's business from competition from partners. What was primarily important in that connection was not who owned an entity that was competing but that there be no greater or more effective competition. It was of course possible for the parties to protect TWE from competition with respect to scheduled
businesses that any partner controlled: they would not be permitted to initiate new competitive activities. But there was no effective way for the partners contractually to protect TWE from increased competition from entities that others controlled (such as TBS). They did the next best thing, however: they agreed to use their influence not to [*59]encourage any such entity to enter a new line of competitive activity. See p.16 supra.

A second sort of change in a competing (scheduled) business--change in the size of the stake a partner held in a competing enterprise--would seem to be far less important to TWE or partners in it, since such a change would not increase any market competition faced by TWE. Indeed, an increase in the size of partner's stake in a competing business might be beneficial to TWE since it would tend to bring that enterprise more under the influence of a partner with a substantial interest in TWE. Thus, for example, increasing TWI's interest in TBS to a controlling position offers the potential for greater protection to TWE's competing business than when assets were controlled by others (possibly maturing into an opportunity for TWE to acquire TBS, for example).

This fact doesn't alone make an increase in the managing partner's stake in a competing business a matter of no concern to limited partners. But considered with other pertinent facts (e.g., U.S. WEST's dominant interest was to acquire an interest in TWE's cable properties; TWI's insistence in retaining its TBS stake and rights under[*60] the TBS Shareholders Agreement outside of TWE; and TWI's expressed view that any TBS entertainment or programming assets that came under TWI's control would be offered to TWE), it helps explain why TWI's rights to increase its TBS stake without prior approval of the TWE limited partners was not a matter of active negotiation. I conclude from the above that U.S. WEST didn't care much about whether TWI could increase its interest in TBS. Certain U.S. WEST witnesses claimed that it would have been important had U.S. WEST understood the existing understanding of TWI's rights respecting TBS, but I can accept that only as a self-serving retrospective interpretation of events.

While one might conclude that this failure to pursue the implications of the retention by TWI in 1991 and 1993 of rights under the TBS Stockholders Agreement was a result of statements to the effect that TWI was in process of "monetizing" its TBS holding, I conclude otherwise. It is very clear that TWI never expressly bound itself by contract not to exercise its right to increase its TBS stake. Nor, as I am in the process of explaining did it do so implicitly in Section 5.5. Thus, I conclude that the implications[*61] of the retention of rights under the TBS Shareholders Agreement were not pursued by U.S. WEST because it did not regard TWI's rights to increase its TBS stake as material to its plan to invest in TWE, which was instead principally motivated by the desire to get access to TWI cable system assets.

Thus, I conclude that it is more likely than not that U.S. WEST understood that TWI had a right to increase its TBS stake without U.S. WEST's prior concurrence. For purposes of the following last stage of this analysis, however, I assume otherwise.

4. Time Warner had no ground reasonably to understand any such assumed fact: I find little in the record that would persuasively support a finding that Time Warner's negotiators or responsible officers should have known the fact (assumed arguendo) that U.S. WEST understood amended Section 5.5 to prohibit TWI from increasing its investment interest in TBS through exercise of rights under the TBS Shareholder Agreement or otherwise.
U.S. WEST gave no objective indication of such an understanding.

TWI understood that the Original Limited Partners shared its view that Section 5.5 permitted TWI to increase its stake in TBS. Indeed, TWI had after [*62]the formation of TWE exercised TBS Shareholder Agreement rights to increase (albeit not in a significant way) its TBS stockholding. Moreover, Time Warner reasonably believed that Lehman, who represented both the Original Limited Partners in 1991 and U.S. WEST in 1992-93, would have informed U.S. WEST of the understanding shared by the Japanese partners and TWI that TWI could increase its interest in TBS. While there is substantial doubt that the Lehman partner involved had herself seen the Hersch memo, she understood the substance of the nonbinding agreement. Greenthal Dep. 153; Tr. (Schumer) 1212.

Indeed in the absence of any contraindication, what could Time Warner have reasonably understood U.S. WEST's appreciation of TWI's rights under the retained TBS Shareholders Agreement to be? U.S. WEST argues that it understood that, while TWI retained a right to increase its stake, the limited partners would nevertheless have the right to veto any such exercise. While it is possible that a contracting party might carefully retain rights and, at the same time, confer a veto over the exercise of those rights in the other contracting party, this argument seems quite strained. There is nothing[*63] in the course of the negotiations that suggest that that strained meaning was discussed or, if not discussed, from which TWI could divine that U.S. WEST entertained that interpretation.

It is true that the merger agreement now in place does not represent an exercise of rights under the Shareholders Agreement. But that fact is irrelevant to the question the case poses. For if plaintiff is incorrect that Section 5.5 precluded Time Warner from unilaterally increasing its TBS stake from that held at closing, it is an immaterial detail whether it later increased that stake by reason of exercise of its retained rights or by exercise of a residual right to make contracts and enter transactions.

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For the foregoing reasons I conclude that (1) amended Section 5.5 is capable of alternative reasonable constructions; (2) the reasonable reading put forward and relied upon by Time Warner is one that the plaintiff knew of at the time and, in all events, should have known of given the circumstances; and (3) that the alternative construction advanced by U.S. WEST was not understood, nor should it have been understood by Time Warner. I therefore conclude that the interpretation advanced by defendant[*64] succeeds in identifying the contractual rights and duties created by the parties. Under that construction U.S. WEST has no contract right to prevent Time Warner from closing on its contract to merge with TBS.

IV.

I now turn to review an argument that acquisition of TBS by Time Warner would constitute a violation of a fiduciary duty of loyalty owed to U.S. WEST as a limited partner of TWE and, as such, should be enjoined. Preliminarily, I note that the equitable obligation imposed upon fiduciaries in circumstances of trust and dependency extends in these circumstances to Time Warner as the entity that controls TWE, even though it does so through the intermediation of several wholly owned subsidiaries that serve as the general partners of that enterprise. See In Re USA Cafes L. P. Litig., Del.Ch., 600 A.2d 43 (1991); Boxer v. Husky Oil Co., Del.Ch., 429 A.2d 995, 997 (1981)
As has often be observed, however, to say that one owes a fiduciary duty is simply the beginning of analysis. At the core of the fiduciary duty is the notion of loyalty - the equitable requirement that, with respect to the property subject to the duty, a fiduciary always must act in a good faith effort [*65] to advance the interests of his beneficiary. A fiduciary duty is not a simple moralism; it supplies an important component of the utility of any form of organization that promotes capital aggregation from many sources. It safeguards investors in placing funds in the hands of others for indefinite periods, without contracted for returns, and in delegating to managers very broad and flexible discretion. It does that by providing a backdrop protection--the fiduciary duty of loyalty--that reduces the need for investors and managers to attempt to specify through contract the agent's authority in the myriad sets of future circumstances that may form the occasion for the exercise of manager discretion over the invested funds.


In this case, the fiduciary duty of loyalty may be argued to prohibit Time Warner from acquiring TBS, even assuming (as I have now concluded) that Section 5.5 of the amended Partnership Agreement does not do so. The claim is [*67]that TBS is a substantial competitor of TWE and that (1) the opportunity to acquire it must belong in equity to TWE or (2) control of TBS outside of TWE, as contemplated, will result in on-going conflict of interests problems that in equity the managing general partner should be precluded from occasioning.

The only factual background necessary for an assessment of U.S. WEST's fiduciary duty claims entail recognition that (1) TBS and TWE do engage in competitive activities on a number of fronts and (2) the parties did particularly discuss, in their negotiation, the acquisition of a movie studio outside of TWE.

As to the first factor, I note that both TBS and TWE own film production businesses. For TBS they are New Line Cinema and Castle Rock; for TWE they are Warner Studios, Lorimar and WB Feature Animation. Both own "superstations," TBS Superstation and WGN (TWE). Both own television networks: TBS owns CNN, TNT, and Turner Classic Movies, and TWE owns WB Network, HBO, and Cinemax. Both own cartoon networks: Cartoon Network (TBS) and Kids WB (TWE). Both also own animation studios and film libraries. This listing, of course, does not establish the
actual extent of competition nor its financial significance to either TWE or TBS. For purposes of this analysis, however, I assume that the competition that TBS owned assets represents to TWE operations is substantial. I note nevertheless that the substantial competition implied in this listing is competition that TWE now faces and presumably will face whether or not the injunction sought is granted or denied.

The second record fact that I note as background to resolution of the fiduciary duty claims is the conversation between the parties in which Time Warner representatives expressed the concern that U.S. WEST might circumvent the overall prohibitions of the noncompete through the investments it held outside of TWE. Time Warner used in this connection the example of U.S. WEST acquiring control over a movie studio such as Paramount through its half-owned U.K. subsidiary Tele-West. (Defendant now says that such a statement could not reasonably be understood to override the provisions of 5.5 which permitted the acquisition of TBS--without regard to what assets it held.)

Turning then to the law of corporate opportunities, I note that the phrase is of course a misnomer in this context of a limited partnership, but the principles of fiduciary loyalty upon which the "corporate opportunity" doctrine was erected apply analogously to partnership fiduciaries. See, e.g., Boxer v. Husky Oil Co., Del Super., 429 A.2d 995, 997 (1981). Certainly partnerships are amenable to greater freedom contractually to shape the set of legal relationships that constitute the partnership than are corporations, n25 and his freedom may include clear contracting with respect to "fiduciary duties." n26 But there may be less to this difference between corporations and limited partnerships (or other entities) in this respect than meets the eye. First, there is modernly great flexibility in the corporate form. The corporate charter may, for example, particularize director and officers' duties. Thus, there is no reason why corporate charters cannot contain provisions dealing with corporate opportunities or dealing with the ability of officers or directors to compete with the corporation. Second, and equally importantly, investors in limited partnership or other more explicitly contractual entities (to the extent they are informed) have a limited incentive to invest in entities that broadly and explicitly repudiate a duty of loyalty. Thus, under Delaware law, all forms of business organization that entail passive investors and active managers permit parties at the time of contracting to specify a great deal bearing on the exercise of managerial power, and passive investors in all forms of enterprise have a powerful incentive, insofar as self-interested transactions by the managers are involved, to retain the possibility of later judicial review under a fairness standard. In fact, the underlying principles of fiduciary analysis in both the corporate and the partnership context reflect a similar principle: given no defect in process (e.g., fraud, nondisclosure, or manipulation) explicitly negotiated and validly adopted provisions of a constitutional document will be enforced. n27

n25 Compare 6 Del. C. § 17-303(a) ("a [limited] partnership agreement may provide for the taking of an action, including the amendment of the partnership agreement, without the vote or approval of any limited partner. . . ") with 8 Del. C. § 242(b) (mandatory class vote of shareholders to amend charter).

n26 6 Del. C. § 17-406.

[*71]
n27 I except from the foregoing consideration of the effect of corporate bylaws which of course may customarily be adopted by the directors alone.

The treatment of "corporate" opportunities by a managing person or entity (or person controlling one) is a rather prominent candidate for explicit contracting in this age of limited partnerships and corporate joint ventures. See, e.g., U.S. Cellular Investment Co. v. Bell Atlantic Mobile Systems, Inc., Del. Supr., A.2d (May 29, 1996). Indeed Section 5.5 of the Partnership Agreement and its 1993 amendment in effect deal with this subject. But that section arguably left a lacuna into which this dispute fell. It is apparent that U.S. WEST, even if it is deemed to have understood that TWI had the right to increase its position in TBS, did not foresee that TBS would own a major film production studio at the time of such exercise and thus exercise of any such right by TWI would place the managing partner in a position in which significant conflicts of interests became likely. TWI did not foresee this eventuality either. Mr. Aboodi's[72] statements concerning only owning a movie studio through TWE would appear disingenuous at best were one to conclude that he had in mind the possibility that TWI might be able to own a film studio outside the TWE structure should TBS independently acquire one. The better reading of the evidence is that neither party foresaw this eventuality.

Circumstances have arguably changed from the time of contracting in a way that the parties did not foresee. While above I conclude that the contract does not preclude TWI from increasing its TBS stake, the contours and effect of TWI's fiduciary duty now, at the time it seeks to exercise the right in changed and unforeseen circumstances, present a different question to which I now turn. n28

n28 It is elementary in fiduciary law that the existence of a legal power or right in the hands of a fiduciary does not preclude equitable relief restraining exercise of that power or right in equity in appropriate circumstances. The distinction between legal right and equitable obligation is the foundation of trust law and of much in corporation law.

[*73]

An extended analysis seems unnecessary. With respect to the question whether acquisition of TBS is an opportunity that belongs in equity to TWE, I must conclude that it is not. The elements of misappropriation of a corporate opportunity were recently restated by our Supreme Court. The fundamentals may be stated as follows: is the opportunity in the line of business of the corporation or other entity to whom the duty is owed; would the opportunity be advantageous to the entity; does the entity have the means to take advantage of the opportunity; and will taking the opportunity bring an officer or director into conflict with the entity? See Broz, 673 A.2d 148; Guth v. Loft, Inc., Del.Supr., 23 Del. Ch. 255, 5 A.2d 503 (1939). Each of these fundamental points may involve subtleties, of course, but I need not dilate on any of them here because it is clear that either (1) the acquisition of TBS will result in TWE acquiring TBS's entertainment assets or (2) it will have been demonstrated that TWE would not be able to acquire TBS, in any event. The evidence indicates that Time Warner would prefer to manage the TBS assets in the same structure as the TWE assets. To that end it has[74] committed in this proceeding (as it did in a non-binding fashion in the Hersch Memorandum) to contribute TBS (sans CNN) to TWE at a fair price. In light of
this fact TWE may acquire the TBS assets but it may do so only if U.S. WEST and TWI can come to an agreement on price. But if they are unable to do so, n29 one could not say that TWI is taking an asset that TWE could profitably seize. In fact this litigation is definitely not about whether TWE or TWI that should have the opportunity to acquire the TBS assets. The "corporate" opportunity doctrine has no application to these facts.

n29 The parties failure to agree on price is quite possible for a number of reasons including the fact that U.S. WEST has little incentives to increase its investment in "content" assets while it has no real managerial power under the Admission Agreement with respect to "content" assets.

Looking at the fiduciary role from the different perspective of the risk of future conflicts of interests that TWI's acquisition of[*75] TBS can be expected to involve does not justify the entry of an injunction at this time either, in my opinion. From this perspective it might be thought that given the relatedness of the businesses of TBS and TWE, control by Time Warner of both TBS and TWE will inevitably lead to repeated instances in which a project or investment is presented to TWI which may meet the business opportunity doctrine standards with respect to both firms. In such circumstances TWI as the managing partner of TWE and as the owner of 100% of the equity of TBS will have a financial conflict. The position may be advanced that in such circumstances superintendence of the relationship between a general partner and limited partners, by (often disaggregated and rationally passive) investors would be very costly and imperfect and that where the constitutional documents of the entity do not specifically address the subject, the better default resolution would be a rule simply prohibiting the fiduciary from placing itself in this difficult position in the first place.

That position has conceptual force. But I am not persuaded that enforcement of any such rule through an injunction would be equitable here. Notably, [*76]plaintiff is not a member of large class of disaggregated investors for whom monitoring of substantial investments by TBS would be impractical or very costly. Secondly, as alluded to at the outset of this opinion, there are a number of steps that TWI may take to deal with the unforeseen difficulty that closing on the TBS transaction will make likely. See note 2 supra. Thus, although a ruling that a general partner cannot create a structure in which conflicting interest transactions will inevitably arise (absent express authorization in the firm's constitutional documents) would make sense in general, here, where the parties are engaged in fundamental renegotiation of their relationship, I cannot in equity foreclose the fiduciary from attempting to meet its obligation of loyalty to TWE in a difficult, case-by-case manner. I therefore decline to enjoin the closing of the TBS acquisition on the ground that it will create an unmanageable conflict over time, to the possible detriment of U.S. WEST.

V.

Finally, I turn to a claim that Time Warner is guilty of fraud in deliberately concealing the Hersch Memorandum from U.S. WEST. The elements of fraud are well established: plaintiff[*77] must show that defendant (1) made a false statement or omitted to disclose a fact under circumstances in which it had a duty to make a disclosure (2) with an intent to deceive plaintiff, and (3) the matter falsely stated or omitted was material to plaintiff (4) who reasonable relied upon it (5) to its detriment. See, e.g., Gaffin v. Teledyne, Inc., Del.Supr., 611 A.2d 467 (1992); Stephenson v.

The typical remedies for fraudulent inducement to contract are rescission, restitution and damages. U.S. WEST does not seek such remedies, however. It has not sought to prove that it was damaged by the facts that it claims constitute fraud. That is, it does not assert that the TWE investment was less remunerative than other available investments options which it would have pursued had the Hersch Memorandum been disclosed. Nor does it seek a rescission—a judicial unwinding of TWE—on the basis that its participation was fraudulently obtained. The absence of a request for either remedy makes it difficult for U.S. WEST to argue that the nondisclosed matter was material to its decision to invest or that it relied upon an allegedly misrepresented state of facts. In effect, by not seeking rescission and restitution it is saying that it affirms the deal it made when it didn't know about the Hersch Memorandum, but it seeks something more than that deal. U.S. WEST seeks as a remedy for the nondisclosure of the Hersch Memorandum an order enjoining defendant from exercising its retained rights under the TBS Shareholders Agreement or to otherwise increase its stake in TBS. Cf. Bernstein v. Vestron, Inc., Del. Ch., C.A. No. 8404, Allen, C. (Mar. 11, 1986), Mem. Op. at 10 (alleged false statement of future intent in offering document would not be specifically enforced as an implied covenant). But I need not rely on the resolution of this issue because the record does not persuade me that the nondisclosure of the Hersch Memorandum constituted fraud or equitable fraud.

n30 See, e.g., George E. Palmer, THE LAW OF RESTITUTION § 3.3 et seq. (1978).

The parties do not very much discuss in their briefing this aspect of the case nor the unusual form of remedy that plaintiff seeks. I rather doubt whether such a remedy would be appropriate if the elements of fraud were shown. To grant the remedy sought would effectively be to specifically enforce a contract other than the one that has now been found to be their contract. That modified contract would contain covenants by TWI not to exercise retained rights under the TBS Shareholders Agreement or to otherwise increase its stake in TBS. Cf. Bernstein v. Vestron, Inc., Del. Ch., C.A. No. 8404, Allen, C. (Mar. 11, 1986), Mem. Op. at 10 (alleged false statement of future intent in offering document would not be specifically enforced as an implied covenant). But I need not rely on the resolution of this issue because the record does not persuade me that the nondisclosure of the Hersch Memorandum constituted fraud or equitable fraud.

n31 If plaintiff sustained its burden in proving fraud, the court might then consider whether any form of equitable estoppel predicated upon a nondisclosure was permissible and whether the requirements of such a remedy could be found here. That, however, is unnecessary because the elements of fraud (or equitable fraud) are not shown in the evidence.

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Turning to the substance of the fraud claim, U.S. WEST asserts that it was mislead into entering the Admission Agreement by TWI's failure to disclose the Hersch Memorandum. It thus must assert—and does—that it relied on that omission. That is, it asserts that if it had known of the contents of the Hersch Memorandum it would have realized that TWI asserted the right under Section 5.5(b)(iii) to acquire TBS. Moreover, it must assert—and it does—that if it had that knowledge, it would have done something different. U.S. WEST claims in this regard that it would not have made the investment in TWE or would have at least bargained for substantially different terms; it feels aggrieved by the nondisclosure in that it made an investment which it says it would not have otherwise made.
Above, however, I concluded that the evidence instead indicates that it is more likely than not that U.S. WEST understood that Time Warner believed itself entitled to exercise rights to increase its TBS stake without the prior approval of the limited partners, and that U.S. WEST understood that TWE would manage any entertainment assets of TBS over which it got control through TWE, if that could be agreed, Tr. (Aboodi) 1073, 1074. These conclusions are inconsistent with the assertion that the text of the Hersch Memorandum would have constituted a material matter to U.S. WEST or, more to the point, that its non-disclosure was relied upon by plaintiff. In so stating, I acknowledge the testimony of plaintiffs' witnesses at trial that this would have been a significant point to U.S. WEST. Much in the record, however, is inconsistent with that self-serving testimony, as described above. See, e.g., Tr. (Williams) 172.


I pass over the question of duty as unnecessary to address and turn to a second critical defect in plaintiffs' fraud theory: the failure to prove the element of scienter or intent to defraud. There is no persuasive evidence that the failure to disclose the Hersch Memorandum was intended to mislead U.S. WEST or to hide the facts set forth in that paper. The evidence suggests strongly that the fact of the nondisclosure of the Hersch Memorandum is explained by oversight and miscommunication. Time Warner agents incorrectly assumed that Lehman Brothers had shared with U.S. WEST the original parties' understandings concerning the TBS holding, insofar as U.S. WEST might be interested in that background. This was a reasonable assumption in the circumstances. There was no reason that the original partners would seek to preserve a confidence with respect to TWI's expressed intention to offer TBS to TWE should it come to acquire it. If U.S. WEST became a limited partner, it would share in such benefits as that non-binding understanding might afford. Moreover, TWI's negotiators testified that they told U.S. WEST of that intention. But even if that testimony were not credited, the lack of a conscious intent to mislead appears as the more reasonable reading of the evidence. The evidence reflects no good ground to find any incentive on TWI's part to keep its non-binding undertaking from U.S. WEST, and I conclude that it represented innocent oversight and misunderstanding.

Plaintiffs' attempt to fit an "equitable fraud" theory to these facts, which theory would make superfluous a requirement of intent to defraud, also fails. The idea of equitable fraud, stated generally, is that where its special jurisdiction is properly invoked, a court of equity may give relief to a party who has reasonable relied upon a false statement to his or her detriment. Notably missing from the equitable fraud concept is a requirement to establish scienter as a necessary element of the claim. The notion of equitable fraud does not swallow common law fraud whole because equitable fraud can only be applied in those cases in which one of the two fundamental sources of equity jurisdiction exist: (1) an equitable right founded upon a special relationship over which equity takes jurisdiction, or (2) where equity affords its special remedies, e.g., "rescission, or cancellation; where it is sought to reform a contract . . . or to have a constructive trust decreed." See 37 AM. JUR. 2d Fraud and Deceit § 220 (1968). While here there is an existing fiduciary relationship between Time Warner and U.S. WEST insofar as TWE is
concerned, this claim is one of fraud in the inducement of that relationship. The negotiations were between arm's length bargainers of great sophistication. With respect to this claim, there is not present the "special relationship" prong of equitable jurisdiction.

The only "equitable" element of the claim of fraud in the inducement[84] of the investment is the request for an injunction. But on what ground is an injunction against TWI exercising its legal rights predicated, since no common law fraud or breach of contract has been shown? All that is offered are facts that fail to establish common law fraud coupled with the request for an injunction. Absent a firmer basis in equity jurisdiction, this record does not justify the court in imposing under the equitable fraud rubric an equitable remedy that would be the functional equivalent of implying and specifically enforcing a covenant by TWI not to exercise what is otherwise a reserved right. I confess to doubt whether such a remedy could ever be properly granted. But whether it could or not, in these circumstances, in which the failure to disclose the memorandum resulted from excusable neglect or innocent misunderstanding and plaintiff forwards a dubious claim of reliance and materiality, I cannot conclude that the particular equitable relief sought should be granted.

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For the foregoing reasons, the claims asserted by U.S. WEST will be dismissed with prejudice. A final judgment under Court of Chancery Rule 54(b) will be entered, there being in the circumstances[85] no just reason for delay. A proposed form of judgment may be submitted, on notice, by defendant promptly.

William T. Allen

Chancellor