2011 SPRING MEETING
OF
ABA SECTION OF BUSINESS LAW

LLCs—Important Case Law Developments 2011

2011 SUMMARY OF DELAWARE CASE LAW

RELATING TO

ALTERNATIVE ENTITIES[1]

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[1] Morris Nichols maintains a Cumulative Survey of Delaware case law relating to alternative entities which is updated annually, organized by subject area and includes most cases that address significant alternative entity issues. The entire Cumulative Survey is available on the Morris Nichols website at www.MNAT.com under Publications.

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1. *Sanders v. Ohmite Holding, LLC*, C.A. No. 5145-VCL (Del. Ch. Feb. 21, 2011)

Plaintiff acquired a membership interest in a Delaware LLC that he believed represented a 7.75% interest in the LLC. A year after the acquisition, the LLC claimed that a dilutive event had occurred prior to the time of plaintiff's acquisition that resulted in plaintiff's membership interest actually representing a .000775% interest in the LLC. Plaintiff requested to inspect the books and records of the LLC for the purpose of evaluating the value of his membership interest, the status of the business and financial condition of the LLC, the performance of management and the legitimacy of the dilution of his membership interest. The LLC denied plaintiff's request and this action followed.

In this decision, the Chancery Court addressed the parties' cross-motions for summary judgment. The court stated that to inspect books and records pursuant to LLC Act Section 18-305, a member of a Delaware LLC must establish by a preponderance of the evidence a proper purpose for the inspection. The LLC argued that plaintiff failed to demonstrate a proper purpose because he was not a member at the time of the events he sought to investigate. The court noted that, in the corporate context, the Delaware Supreme Court has rejected this argument, concluding that activities that are reasonably related to a stockholder's interest as a stockholder support access to books and records even if the activities occurred before the stockholder acquired its shares. The court found no reason not to apply the same rule in the LLC context and concluded that plaintiff's purposes—valuing his ownership interest and investigating potential wrongdoing—were proper. With respect to plaintiff's purpose of investigating potential misconduct, the court noted that plaintiff was not obligated to demonstrate that misconduct had occurred. Rather, he must establish a credible basis from which a court can infer mismanagement. The court found that plaintiff had established a credible basis and was therefore entitled to inspect the books and records of the LLC. Finally, the court stated that plaintiff had the burden of demonstrating that each category of books and records requested is essential and sufficient to his stated purpose. Noting that a requirement that books and records literally be both "essential and sufficient" could lead to problematic results, and further noting that the terms "essential," "necessary," and "sufficient" have been used interchangeably in the books and records context, the court stated that the core inquiry is whether the requested documents are reasonably required to satisfy the purpose of the demand. In this case, the court concluded each category of books and records was reasonably required to satisfy plaintiff's stated purposes.

2. *Saliba v. William Penn P'ship,* C.A. No. 111 (Del. Feb. 9, 2011)

Plaintiffs were members of a Delaware LLC that owned a motel as its sole asset, and defendants were members and the managers of the LLC. Defendants surreptitiously arranged for the sale of the motel to another company controlled by defendants using a deceptive and manipulative sale process. Plaintiffs brought an action in the Chancery Court for breach of fiduciary duty alleging that defendants' breached their duty of loyalty, and the Chancery Court agreed with plaintiffs. In assessing the damages that should be awarded to plaintiffs, the Chancery Court determined that the sale price of the motel paid by defendants was greater than its appraised price. Since there were no compensatory damages available to plaintiffs, the Chancery Court exercised its

discretionary powers to award plaintiffs their attorneys' fees and costs, stating that it would be unfair and inequitable for plaintiffs to bear the costs of litigation arising from a successful breach of fiduciary duty claim against defendants.

In this decision, the Delaware Supreme Court addressed an appeal by defendants of the Chancery Court's decision. The Supreme Court began by stating that, because the LLC agreement did not modify or eliminate fiduciary duties, defendants owed the traditional fiduciary duties of loyalty and care to the other members of the LLC. The court then found that by standing on both sides of the sale transaction, the managers were required to demonstrate the entire fairness of the transaction in order to show they had complied with their duty of loyalty. In order to demonstrate the entire fairness of the transaction, the court required that defendants show both fair dealing and fair price. The court described fair dealing as involving an analysis of the structure, timing, disclosures and approvals for the transaction and fair price as involving the economic and financial considerations of the transaction. The court stated that "a party does not meet the entire fairness standard simply by showing that the price fell within a reasonable range that would be considered fair." The court found that defendants had manipulated the sale transaction through multiple misrepresentations and material omissions. Defendants argued that the deal was ultimately fair, however, because the sale price was higher than the appraised price. The court rejected defendants' argument and found that defendant's manipulation of the sale process denied plaintiffs the benefit of knowing the price a fair bidding process might have brought. The Supreme Court thus affirmed the Chancery Court's determination that defendants' had breached their fiduciary duties.

3. *Techmer Accel Holdings, LLC v. Amer*, C.A. No. 4905-VCN (Del. Ch. Dec. 29, 2010); *Techmer Accel Holdings, LLC v. Amer*, C.A. No. 4905-VCN (Del. Ch. Feb. 8, 2011)

This case involved a suit by a creditor and certain of its affiliates against Crescent Private Capital L.P., a Delaware limited partnership ("Crescent"), Crescent's general partner ("Crescent GP"), and Crescent GP's managing member. As a result of a transaction in which the creditor acquired Crescent's last portfolio company, the creditor had a potential claim for indemnification against Crescent. Crescent distributed most of the proceeds from the transaction to its partners, but retained funds in excess of the potential indemnification liability. The creditor later made a claim against Crescent for indemnification, and while a related arbitration proceeding was pending, certificates of cancellation were filed on behalf of Crescent and Crescent GP terminating their status as legal entities. Plaintiffs then brought this action alleging that Crescent was wound up in contravention of DRULPA Section 17-804 by failing to make adequate provision for Crescent's liabilities before the filing of its certificate of cancellation and seeking the nullification of its certificate of cancellation and the appointment of a receiver pursuant to DRULPA Section 17-805 to manage the affairs of Crescent. Defendants contended that there was no violation of Section 17-804 because Section 17-804 applies only to distributions following the dissolution of a limited partnership and Crescent made no distributions following its dissolution.

In its decision, the court addressed the parties' cross-motions for summary judgment. The court began its analysis with an interpretation of the statutory language of Section

17-804 to determine whether Section 17-804 only applies to distributions occurring after the dissolution of a limited partnership. The court noted that under the canons of statutory interpretation the threshold question was whether Section 17-804 is ambiguous. The court first looked at whether Section 17-804 is ambiguous based on a susceptibility to alternate interpretations and concluded that Section 17-804 is not ambiguous, pointing to language in Section 17-804 that makes clear that its limitations and requirements apply only to "[a] limited partnership which has dissolved" and "[u]pon the winding up" of a limited partnership's affairs. The court also considered whether ambiguity might exist on the basis that the plain language of Section 17-804 produces unreasonable consequences in light of legislative intent. The court stated that under a literal reading of Section 17-804, a limited partnership could largely avoid the limitations of Section 17-804 by making a distribution to its partners prior to dissolution and, so long as the distribution did not violate Section 17-607 (which governs partner distributions before dissolution), the distribution would fall outside the scope of Section 17-804. The court held that, although a literal reading of Section 17-804 "creates the potential for offensive behavior," Section 17-804 makes clear that the legislature intended different methods of protecting creditors based on the status of the limited partnership—that is, Section 17-804 clearly applies only upon the dissolution of a limited partnership and Section 17-607 affords protection to creditors prior to dissolution.

Having concluded that Section 17-804 applies only upon the dissolution of a limited partnership, the court then turned to the issue of whether Crescent had dissolved prior to the date of the distribution to its partners. Defendants contended that Crescent dissolved on April 30, 2009, which was the expiration date of the ten-year term of Crescent set forth in its partnership agreement. Plaintiffs, on the other hand, argued that Crescent's dissolution and winding up began as early as April 2007 based on other potential events of dissolution. The court concluded that dissolution occurred at the latest on April 21, 2009 when the certificate of cancellation of Crescent GP was filed. The court, however, was unable to determine on the record before it whether Crescent's dissolution had occurred at an earlier point in time. Since the court could not determine whether Crescent had dissolved prior to the partner distribution, it also was unable to determine whether the contested distribution was subject to Section 17-804. Because Crescent had approximately $59,000 in assets left undistributed at the time its certificate of cancellation was filed, the court did conclude, however, that Crescent had not complied with the requirement under DRULPA Section 17-203 that its winding up be completed before the filing of its certificate of cancellation.

The court then addressed plaintiffs' requests to nullify the certificates of cancellation of Crescent and Crescent GP and to appoint a receiver to manage Crescent's affairs. Under DRULPA Section 17-805, a court may appoint a receiver only when a certificate of cancellation has been filed on behalf of a limited partnership and the party requesting appointment shows good cause. In this case, the court concluded that good cause to appoint a receiver existed because Crescent, having outstanding liabilities and retained assets when its certificate of cancellation was filed, failed to settle and close its business properly. The court, however, rejected plaintiffs' request to nullify the certificates of cancellation, finding instead that appointment of a receiver provided the necessary relief under the circumstances.

In a subsequent decision by the court, the court addressed defendants' motion for reargument of the court's appointment of a receiver under DRULPA Section 17-805. In support of their motion, defendants offered evidence that Crescent did not have assets that had not been disposed of at the time of the filing of its certificate of cancellation. The approximately $59,000 in assets that earlier facts had indicated remained in Crescent at the time it certificate of cancellation was filed had in fact been distributed to Crescent's accounting firm in payment for preparation of Crescent's final tax return and to Crescent GP in partial payment of management fees payable. The court stated that even if it accepted the new evidence as true, it would not change the court's conclusion that Crescent had not made a proper settlement of its unfinished business as required by DRULPA Section 17-203 because it had not made reasonable provision under DRULPA Section 17-804 to pay its indemnification obligation to plaintiffs. The court thus rejected defendants' motion for reargument.

4. *Wimbledon Fund LP—Absolute Return Fund Series v. SV Special Situations Fund LP*, C.A. No. 4780-VCS (Del. Ch. June 14, 2010); *Wimbledon Fund LP—Absolute Return Fund Series v. SV Special Situations Fund LP*, C.A. No. 4780-VCS (Del. Ch. Feb. 4, 2011)

This decision of the Chancery Court on cross-motions for summary judgment involved a dispute between an investment fund, SV Special Situations Fund LP (the "Fund"), and one of its limited partners, Wimbledon Fund LP-Absolute Fund Series ("Wimbledon"). The partnership agreement of the Fund restricted a limited partner from withdrawing from the Fund for one year from its initial investment, and any such withdrawal could only occur on June 30 or December 31. Wimbledon sought to withdraw from the Fund before the expiration of the one year lock up period by sending the Fund a request to withdraw effective on June 30, 2008. The Fund did not consent or object to Wimbledon's request on or before June 30, 2008. In September 2008, the Fund acknowledged Wimbledon's withdrawal request in a short letter. On October 31, 2008, the Fund notified all of its limited partners that it was suspending all pending and future withdrawal requests. Wimbledon argued that the suspension did not apply to its withdrawal because (a) its requested withdrawal was effective on June 30, 2008, which was prior to the announced suspension, and (b) despite its premature request, its request was effective because the Fund consented in the September 2008 letter to its early withdrawal.

Under DRULPA Section 17-603, "[a] limited partner may withdraw from a limited partnership only at the time or upon the happening of events specified in the partnership agreement and in accordance with the partnership agreement." Under the terms of the Fund's partnership agreement, the only means by which Wimbledon could withdraw from the Fund on June 30, 2008 was by the Fund's express consent. As discussed by the court, an express waiver exists "where it is clear from the language used that the party is intentionally renouncing a right that it is aware of," and an implied waiver is found "only if there is a clear, unequivocal, and decisive act of the party demonstrating relinquishment of the right." While the September 2008 letter acknowledged Wimbledon's redemption request and indicated that the redemption would be made on an in-kind basis, the court found that it did not include a clear representation that the Fund

voluntarily and intentionally waived Wimbledon's duty to remain a member of the Fund for at least one year. According to the court, the language in the letter was ambiguous at best, "and ambiguous acts cannot form the basis for a waiver."

Further, the court held that, even if the September 2008 letter indicated that the Fund would effect Wimbledon's withdrawal as of December 31, 2008, such pending request was suspended by the October 31, 2008 notice. The court found that the Fund's partnership agreement plainly provided that "the General Partner shall have the right, in its sole discretion, to suspend all capital withdrawals to Partners" under certain circumstances. According to the court, nothing in the partnership agreement's language limited the Fund's suspension authority to prospective withdrawals, and construing the language otherwise would render that section "meaningless." Because the Fund was authorized under its partnership agreement to suspend pending withdrawal requests, the court held that the suspension was effective as to Wimbledon when the Fund delivered the October 2008 letter. Therefore, the court denied Wimbledon's motion for summary judgment and granted the Fund's motion for summary judgment.

Following the Chancery Court's initial decision, the Delaware Supreme Court remanded the case back to the Chancery Court based on an appeal by Wimbledon to supplement the record with two additional documents Wimbledon subsequently discovered. The first document was a September 29, 2008 capital account statement from HSBC, the Fund's administrator, that indicated that Wimbledon's entire capital account balance was withdrawn from the Fund in July, 2008. The second documents was the Fund's 2008 Form K-1 for Wimbledon that showed Wimbledon's ending capital investment in the Fund for the year 2008 was zero. The Chancery Court concluded that based on the Chancery Court's rules of procedure the supplemental evidence should not be considered and the Chancery Court's initial decision should remain in effect. In the event the Supreme Court later determined that the Chancery Court must consider Wimbledon's supplemental evidence, the Chancery Court held that the supplemental evidence did raise genuine issues of material fact as to whether Wimbledon withdrew from the Fund prior to the Fund's suspension of withdrawals such that Wimbledon's and the Fund's motions for summary judgment should be denied. The court held that the supplemental evidence supported a reasonable inference that the Fund had waived the one year lock up period and actually effected Wimbledon's withdrawal prior to the October 2008 letter suspending withdrawals. The court went on to state that if Wimbledon's withdrawal was effective prior to the October 2008 letter, it would not have been a partner at the time of the October 2008 letter and since the Fund's partnership agreement only provided the Fund the right to suspend withdraws of partners, the October 2008 letter would not have been effective with respect to Wimbledon, even though Wimbledon had not yet received any distribution in respect of its withdrawal.

5. *Grunstein v. Silva,* C.A. No. 3932-VCN (Del. Ch. Jan. 31, 2011)

In this decision, the Court of Chancery addressed, among other things, defendants' motion for summary judgment on plaintiffs' claim that defendants had breached an oral partnership agreement. Defendants argued that plaintiffs failed to prove that a partnership agreement ever existed, pointing to the existence of several unsigned drafts of

partnership agreements as evidence that no definitive partnership agreement had ever been entered into among plaintiffs and defendants.

The court began its analysis by stating that under DRUPA Section 15-202(a), "a partnership is formed when two or more persons either (i) operate a for-profit business as co-owners or (ii) carry on any purpose or activity not for profit if the persons intend to form a partnership." The court noted that there is no single test that is determinative of whether a partnership exists; rather, existence of a partnership is a question of intent. According to the court, a partnership exists if the parties had a "common obligation to share losses as well as profits." The court stated that it looks at the language of any agreement and at "the parties' acts, dealing, conduct, and admissions" to determine whether a partnership has been formed and that, as with any other contract, a partnership agreement will be enforceable only if it contains all material terms.

In this case, the court found that the existence of unsigned drafts of a partnership agreement did not automatically prove that the parties' never entered into a partnership agreement. The plaintiffs argued that an oral partnership agreement was reached at the beginning of the parties' relationship, and since none of the later versions of the partnership agreement had been signed, the initial oral partnership agreement controlled. The court stated that it would eventually need to evaluate the credibility of plaintiffs' explanation for why the drafts of the partnership agreement had not been signed but not on a motion for summary judgment. The court thus denied the defendants' motion for summary judgment.

6. *CNL-AB LLC v. Eastern Property Fund I SPE (MS REF) LLC,* C.A. No. 6137-VCP (Del. Ch. Jan. 28, 2011)

This case came before the court on a motion for a preliminary injunction by the counterclaimant/third-party plaintiff ("counterclaimant"). The counterclaimant was a unitholder in an LLC that was the indirect owner of several resort properties. The plaintiff made mezzanine loans to several of the entities in the structure. When the various entities defaulted on their loans, the plaintiff brought foreclosure proceedings against certain resort properties that were indirectly held by the LLC. The counterclaimant petitioned the court for a preliminary injunction to enjoin the foreclosure, claiming that the managing member of the LLC breached its fiduciary duties to the counterclaimant by entering into an agreement with the plaintiff which allowed the foreclosure in exchange for releases from guarantees of the loans and other consideration.

The Vice Chancellor denied the counterclaimant's request for a preliminary injunction based on the doctrine of laches, but also found that counterclaimant had failed to demonstrate a probability of success on its breach of fiduciary duty claim. The LLC's operating agreement restricted the fiduciary duties of the managing member in accordance with 6 *Del. C.* § 18-1101 of the LLC Act. The operating agreement gave the managing member the sole and absolute discretion to execute, deliver and perform any agreement authorized by the operating agreement. It further stated that the managing member need not consider any other obligation or duty, fiduciary or otherwise, of the LLC or the members, and that such execution, delivery or performance would not

constitute a breach of any duty the managing member might have owed to the LLC or any other person under the operating agreement, or any duty stated or implied by law or equity. Also, the operating agreement absolved the managing member from liability for monetary and other damages, unless the managing member acted in bad faith and the act/omission was material to the matter giving rise to loss, liability or benefit not derived. The court found that these provisions put the burden on the counterclaimant to prove the managing member acted in bad faith, a burden the counterclaimant could not carry.

Furthermore, the court found that even if the counterclaimant were able to prove that the managing member acted in bad faith, it would not be able to prove that the managing member's actions were material to its loss as the court found that plaintiff was able to foreclose on the resort properties without the agreement of the managing member.

Finally, the court found that there was no breach of fiduciary duty because the managing member could not cause the counterclaimant to lose any asset of value. The counterclaimant's equity interest was junior to all of the debt, including the plaintiff's loans. The LLC defaulted on all of the loans, so, regardless of the agreement between the managing member and the plaintiff, foreclosure would have left the counterclaimant with nothing.

7. *Lavi v. Wideawake Deathrow Entm't, LLC,* C.A. No. 5779-VCS (Del. Ch. Jan. 18, 2011)

In response to an action by a member to compel inspection of the books and records of the defendant LLC, defendant filed a motion to dismiss, which included multiple exhibits, ranging from pleadings in other cases to correspondence between the plaintiff and the defendant. The court determined that defendant's approach was procedurally improper because it was more like a motion for summary judgment than a motion to dismiss. The court noted that books and records actions are summary proceedings and cited to Section 18-305(f) of the LLC Act for support. The court explained that "summary proceedings" are to be promptly tried and that rarely is dispositive motion practice efficient when the case can be tried within two months of filing. Accordingly, the court denied defendant's motion to dismiss because it was procedurally defective and did not address the viability of plaintiff's pleading.

8. *Great-West Investors LP v. Thomas H. Lee Partners, L.P.,* C.A. No. 5508-VCN (Del. Ch. Jan. 14, 2011)

This case was before the court on the defendant's motion to dismiss. The parties disputed the meaning of a provision in a limited partnership agreement that was designed to provide a default calculation for determining the amount of a certain fee owed to the general partner. The provision stated that if, by good faith negotiation, the parties could not come to an agreement, the fee would "increase . . . by an amount equal to the product of 1.05 <u>multiplied by</u> the Expense Assumption in effect during the preceding year."

The plaintiff requested, among other things, two declarations from the court. First, the plaintiff asked for a declaration that the provision required the defendant to negotiate in good faith before the default calculation became effective. Second, the plaintiff

requested a declaration that the contract provided for an annual 5% increase in the amount owed to the general partner. In relation to the first request, the defendant argued that its attempts at negotiating with the plaintiff were in good faith, but did not offer a different interpretation of the language. The court decided that the plaintiff's interpretation of the provision was at least a reasonable reading, and based on the facts alleged by the plaintiff denied the defendant's motion to dismiss.

With respect to the second request for declaratory relief, the defendant argued that the plaintiff's claim should be dismissed because the language unambiguously provided for a yearly 105% increase over the amount from the prior year. The plaintiff argued that the language was at least ambiguous and insisted that the defendant's interpretation produced an unconscionable and absurd result. However, the court agreed with the defendant and found that the language unambiguously provided for an annual 105% increase in the fee. The court noted that it is not to twist otherwise clear language to fit its sense of fairness, and that "parties are free to make bad bargains." The court granted the defendant's motion to dismiss the plaintiff's claim on this issue.

The court denied the defendant's motion to dismiss the plaintiff's claim for specific performance of the defendant's obligation to negotiate in good faith, including the defendant's duty to provide certain financial information and defendant's motion to dismiss the plaintiff's breach of contract claim. Further, the court denied the defendant's motion to dismiss the plaintiff's claims for reformation under the theories of mutual mistake, unilateral mistake and fraud (although the court noted that reformation based on fraud was a close call).

Finally, the court granted the defendant's motion with respect to the plaintiff's claims for breach of fiduciary duty (determining that such claims were superfluous because they were based on the same actions as the breach of contract claims). The court also granted the defendant's motion on the plaintiff's breach of the implied covenant of good faith and fair dealing. The court briefly mentioned that the implied covenant only applies where a contract lacks specific language governing an issue. Since the dispute was based on the language of the contract, the implied covenant did not apply.

9. *Connecticut General Life Ins. Co. v. Pinkas,* C.A. No. 5724-VCN (Del. Ch. Nov. 18, 2010)

In this case, Third-Party Defendants, who were current or former partners of Brantley Partners IV, L.P., a Delaware limited partnership (the "Fund"), moved to have the Court of Chancery modify a status quo order to permit the Fund to advance Third-Party Defendants' legal fees and expenses. The limited partnership agreement of the Fund provided for advancement to the Fund's general partner, and to the general and limited partners, agents and employees of the Fund's general partner, of "attorneys' fees and expenses which arise out of or *in any way relate to* the Partnership . . . or which arise by reason of any of them being the General Partner, or a partner, employee, or Partner." (emphasis added). Third-Party Defendants had been accused by the Fund's general partner of breaching their fiduciary duties to, and of participating in a conspiracy to remove, the Fund's general partner. The court held that although it may be attenuated,

the nexus between these claims and the Fund was sufficient to satisfy the very broad "in any way relate to" language of the advancement provision. The right to advancement was subject to another provision of the Fund's partnership agreement that required potential indemnitees to first seek advancement from other available sources. Third-Party Defendants argued that such provision applied only to indemnification and not to advancement, but the court found that the term indemnification was used in the partnership agreement to refer to both advancement and indemnification. Third-Party Defendants also argued that advancement was not available from other sources. The court held that Third-Party Defendants successfully demonstrated that advancement was unavailable from other sources and thus granted Third-Party Defendants' request to modify the status quo order to permit the advancement.

10. *GTSI Corp. v. EYAK Technology, LLC,* C.A. No. 5815-VCL (Del. Ch. Nov. 15, 2010)

This case was before the court on a motion to stay pending arbitration. The plaintiff owned 37% of the membership interest in the defendant LLC. The LLC Agreement contained a provision that called for the winding up and dissolution of the company upon certain events, unless Members with at least 65% of the vote agreed to continue the business. One of the requisite events occurred and the plaintiff, with its 37% membership interest, blocked continuation of the company. The defendant refused to hold a meeting of the members and the plaintiff sought various forms of permanent relief from the court.

The LLC Agreement contained a broad arbitration clause that covered "any dispute . . . (including the validity, scope, and enforceability of these arbitration provisions)". However, another clause stated that "notwithstanding the foregoing agreement to arbitrate, the parties expressly reserve the right to seek provisional relief from any court of competent jurisdiction to preserve their respective rights pending arbitration."

The plaintiff argued that, under *James & Jackson, LLC v. Willie Gary, LLC* (Del. 2006), the court first had to determine whether the LLC Agreement generally provided for the arbitration of all disputes. However, the *Willie Gary* LLC Agreement did not contain language regarding whether the parties were to arbitrate substantive arbitrability. In contrast to *Willie Gary*, the language in the defendant's LLC Agreement clearly showed that the parties intended the arbitrator to determine substantive arbitrability. The lone exception set forth in the defendant's LLC Agreement was that the parties could seek provisional relief from the court, rather than from an arbitrator. However, the plaintiff in this case was seeking permanent, not provisional, relief. Therefore, the court granted the defendant's motion to stay.

11. *CML V LLC v. JetDirect Aviation Holdings, LLC*, C.A. No. 5373-VCL (Del. Ch. Nov. 3, 2010)

In this case, the Chancery Court held that creditors of a Delaware LLC do not have standing to bring a derivative suit against fiduciaries of the LLC for breach of fiduciary duties committed while the LLC was insolvent or in the zone of insolvency. The case involved a loan by CML V, LLC ("CML") to JetDirect Aviation Holdings, LLC ("JetDirect"), a Delaware LLC that was engaged in an aggressive strategy of acquiring

small- to mid-sized jet charter and service companies. Insufficient internal controls at JetDirect and poor financial reporting procedures, combined with ill-advised acquisitions resulted in several JetDirect subsidiaries filing for bankruptcy and ultimately the insolvency of JetDirect. After defaulting on CML's loan, JetDirect liquidated some of its assets, with some JetDirect assets sold to entities controlled by certain of JetDirect's managers. CML brought a derivative action alleging breach of fiduciary duty claims against JetDirect. Defendants moved to dismiss these claims based on Section 18-1002 of the LLC Act.

Section 18-1002 provides, in relevant part, that "in a derivative action, the plaintiff must be a member or an assignee of a limited liability company interest at the time of bringing the action . . . ." The court stated that Section 18-1002 "limits standing to bring a derivative claim to holders of membership interests in an [LLC] and their assignees. Section 18-1002 does not grant standing to creditors. Although this limitation might surprise wizened veterans of the debates over corporate creditor standing, JetDirect is not a corporation. JetDirect is an LLC, and the plain language of the LLC Act controls."

The court contrasted the provisions of Section 18-1002 with the provisions of Section 327 of the DGCL, which is the only Delaware corporate statute that addresses derivative actions. Section 327 provides that "in any derivative suit instituted by a stockholder of a corporation, it shall be averred in the complaint that the plaintiff was a stockholder of the corporation at the time of the transaction of which such stockholder complains or that such stockholder's stock thereafter devolved upon such stockholder by operation of law." The court distinguished Section 327 from Section 18-1002 by finding that Section 327, which by its terms applies to any derivative suit instituted by a stockholder, does not limit creditors or any other person from bringing a derivative suit while Section 18-1002, which by its terms states that in a derivative action the plaintiff must be a member or an assignee, creates an exclusive right for members and assignees to bring derivative suits involving an LLC. The court found that Section 327 of the DGCL is non-exclusive--i.e., it speaks only to the "subset of derivative suits" instituted by a stockholder of a corporation--while Section 18-1002 of the LLC Act, on the other hand, is exclusive--i.e., it provides that a plaintiff bringing a derivative claim in the LLC context must be a member or an assignee of a member interest. Thus, the court concluded, a literal reading of the plain language of the LLC Act precludes recognition of derivative standing to creditors of an insolvent LLC.

The court acknowledged that previous decisions of the Chancery Court and most of the commentary on this issue appear to have assumed that the precedent on a creditor's standing to bring a derivative suit against an insolvent corporation also applied to allow derivative suits by creditors in the context of insolvent alternative entities. However, the court determined that the literal terms of the LLC Act barred such a result. The court found support for its literal reading of Section 18-1002 in two earlier Chancery Court decisions, *Vanderbilt Income & Growth Assocs., L.L.C. v. Arvida/JMB Managers, Inc.*, 1996 WL 652773 (Del. Ch. Nov. 4, 1996), and *U-H Acq. Co. v. Barbo*, 1994 WL 34688 (Del. Ch. Jan. 31, 1994), in which the derivative action statutes of the DRULPA and the LLC Act had been read strictly to bar suits by assignees of LP or LLC interests (as

opposed to partners or members). The court noted that DRULPA and LLC Act were each amended in 1998 to authorize assignees of LP or LLC to sue derivatively.

The court recognized that it had the power to avoid a literal interpretation of Section 18-1002 "if a literal reading of the statute would lead to an unreasonable or absurd result not contemplated by the legislature." CML argued that a plain reading of Section 18-1002 would produce an absurd distinction between insolvent corporations, where creditors can sue derivatively, and insolvent LLC, where they cannot. The court disagreed, stating that "[a]s a threshold matter, there is nothing absurd about different legal principles applying to corporations and LLCs," and that limiting creditors to their bargained-for contractual rights and denying them the additional right to sue derivatively on behalf of an insolvent entity is consistent with the "contractarian environment created by the LLC Act." The court then cited to multiple provisions of the LLC Act that allow for the protection of the interests of creditors, including (a) Section 18-101(7), which permits an LLC agreement to provide rights to any person, including a person who is not a party to the LLC agreement, (b) Section 18-306, which provides that members may be subject to specified penalties or consequences for breaching the LLC agreement, and (c) Section 18-502(b), which provides a creditor with the right to enforce a member's obligation to contribute capital to an LLC. The court thus dismissed CML's derivative claims for lack of standing.

12. *In re Inergy L.P. Unitholder Litig.*, Cons. C.A. No. 5816-VCP (Del. Ch. Oct. 29, 2010)

In this case, unitholders of Inergy L.P., a Delaware master limited partnership ("Inergy"), sought to enjoin a merger between Inergy Holdings L.P., the owner of Inergy's general partner and also a Delaware master limited partnership ("Holdings"), and a wholly-owned subsidiary of Holdings' general partner. Inergy had a two-tiered capital structure consisting of common units held primarily by public investors and Incentive Distribution Rights ("IDRs") held exclusively by Holdings. Inergy was not a constituent party to the merger, but was a party to the merger agreement pursuant to which it would issue new common units to Holdings. In exchange, Holdings was to transfer the IDRs to Inergy to be cancelled. In the final step, Holdings was to exchange the Inergy units for its own units held by its unitholders. As a result, former Holdings unitholders would become Inergy unitholders owning 39.6% of outstanding Inergy units and Holdings would become a private entity.

The plaintiffs sought a preliminary injunction on two bases. First, they claimed a breach of Inergy's limited partnership agreement because no vote of Inergy unitholders was sought with respect to the merger. Second, plaintiffs contended that an unfair and unreasonable process to select an unfair and dilutive transaction price constituted a breach of the LP agreement and the fiduciary duties of the directors of Inergy's general partner.

The Inergy LP agreement gave Inergy the power to "merge or consolidate" subject to the consent of a majority of Inergy unitholders. The court concluded that whether Inergy unitholders were entitled to vote turned on whether Inergy was actively "merging" or "consolidating" with another entity. Although Inergy was a party to the merger

agreement, it was not a constituent party to the proposed merger. Therefore, the court concluded it was not merging or consolidating and Inergy unitholders were not entitled to vote. In addition, the court analogized the proposed merger to a triangular merger in the corporate context and noted that in such a scenario Delaware law did not require a vote by shareholders of the non-merging parent corporation. The court also invoked the doctrine of independent legal significance to support its conclusion, noting that the fact that Inergy could have completed the transaction in a manner that conferred the right to vote on its unitholders did not mean it had to do so.

On the second claim, the court noted that the Inergy LP agreement provided a number of potentially relevant standards of care. Section 7.6(e) of the agreement prohibited transfers of property from Inergy to Inergy's general partner (or an affiliate of its general partner) unless such transfers were "fair and reasonable." Section 7.9(a) likewise provided that any resolution of a conflict of interest between Inergy and its general partner (or an affiliate of its general partner) did not breach the LP agreement if such resolution were "fair and reasonable." Section 7.9(a) further provided, however, that actions taken by Inergy's general partner, if taken "in the absence of bad faith," did not breach the LP agreement. Finally, section 7.10(d) modified, waived or limited any standard of care imposed by the LP agreement or applicable law to permit Inergy's general partner to act under the LP agreement, provided that such action was "reasonably believed . . . to be in, or not inconsistent with, the best interests of" Inergy.

The plaintiffs argued section 7.6(e)'s "fair and reasonable" standard governed. The defendants countered that section 7.9(a) and its "bad-faith" carve out applied. Alternatively, the defendants argued that any standard set forth in the LP agreement must be applied in light of section 7.10(d)'s "reasonable belief" standard. The court agreed with defendant's last argument, concluding that section 7.10(d) "expressly and unambiguously" limited any duty imposed by the Inergy LP agreement. The court declined to decide which standard, section 7.6(e) or 7.9(a), controlled because it concluded that in light of section 7.10(d), under either, the plaintiffs failed to demonstrate a likelihood of success on the merits.

In support of their fiduciary claim, plaintiffs argued that the independent special committee (the "ISC") appointed to negotiate the transaction on behalf of Inergy unitholders lacked proper procedural safeguards because it was comprised of only one member. Moreover, plaintiffs argued, the sole ISC member did not properly understand his responsibilities. The court rejected both arguments. First, the court stated that there was no requirement that a body such as the ISC have more than one member and, with respect to this particular transaction, noted that only one member of the board of Inergy's general partner was truly independent of the transaction. The court then cited numerous facts demonstrating that the ISC member understood his role.

The plaintiffs next contended that the ISC chose conflicted legal and financial advisors who were unable to render independent advice. Specifically, the plaintiffs focused on a financial advisor having extensive prior dealings with Inergy and its CEO. The court noted several factors that supported the conclusion that the ISC's selection was both reasonable and in Inergy's best interests. The plaintiffs also complained of a meeting

between the ISC member and Inergy's CEO during the negotiations, but the court found there to be a legitimate reason for the meeting. Finally, the plaintiffs argued that the ISC's decision to pursue a transaction that did not require a unitholder vote evidenced bad faith. In rejecting this argument, the court relied on its earlier discussion of unitholder voting rights and also noted that the ISC relied on legal advice in making the decision.

Finally, the plaintiffs attacked the transaction price in a number of respects. First, they alleged the transaction required Inergy to pay an excessive exchange premium. The court first noted that an exchange premium was to be expected in a transaction of this type in light of the benefit to Inergy from the cancellation of the IDRs. The plaintiffs argued that the exchange ratio should be more favorable. The court, however, accorded little weight to the testimony on this subject by the plaintiff's expert because such expert did not conduct his own independent analysis, conducted his work in a rushed manner, and raised minor quibbles rather than pointing to major flaws. Noting that the transaction arose out of serious, arms-length negotiations over a number of weeks, the court concluded the plaintiffs failed to demonstrate a likelihood of success in their challenge to the transaction price.

13. *In re Atlas Energy Resources, LLC, Unitholder Litig.*, C.A. No. 4589-VCN (Del. Ch. Oct. 28, 2010)

This case involved a publicly-traded limited liability company, Atlas Energy Resources, LLC (the "Company"), which negotiated a merger with its controlling unitholder, Atlas America, Inc. ("America"). The plaintiffs were public unitholders of the Company. The plaintiffs argued that America, as controlling unitholder, breached its fiduciary and other common law duties to the minority unitholders by negotiating the merger through an unfair process that resulted in terms that were unfair to the minority unitholders. The plaintiffs further argued that certain directors of the Company breached their fiduciary duties by agreeing to the merger. The defendants filed a motion to dismiss these claims.

First, the court held that under Delaware law, in the absence of provisions explicitly disclaiming the applicability of fiduciary duties, controlling members in a manager-managed LLC owe minority members the traditional fiduciary duties that controlling shareholders owe minority shareholders. The court also highlighted that it was particularly wary of eliminating such duties in the context of a publicly traded LLC and required either an explicit disclaimer or language mandating a contractual resolution. With respect to whether America had effectively modified its default fiduciary duties, the court found that the relevant provision of the LLC agreement of the Company (the "Operating Agreement") provided that "[w]henever a potential conflict of interest exists or arises between any Affiliate of the Company, on the one hand, and the Company or any Group Member, on the other, any resolution or course of action by the Board of Directors in respect of such conflict of interest shall be permitted and deemed approved by all Members, and shall not constitute a breach of this Agreement . . . or of any duty existing at law, in equity or otherwise, including any fiduciary duty, if the resolution or course of action in respect of such conflict of interest is (i) approved by Special Approval . . . ." In reviewing this provision, the court found that it only governed

conflicts of interest between the Company and its "Affiliates," such as America, but not conflicts of interest between America and the Company's minority unitholders. Thus, the Operating Agreement did not eliminate America's fiduciary duties as the controlling unitholder of the Company to the minority unitholders. Applying the corporate precedent of *Kahn v. Lynch*, the court held that a merger between an LLC and its controlling unitholder must be evaluated under entire fairness notwithstanding any protective devices, such as independent committee review or approval by a majority of the minority unitholders, that may have been employed because, regardless of the protections employed, such a merger is characterized by "inherent coercion."

In discussing whether the merger satisfied the entire fairness standard, the court addressed the issues of fair price and fair dealing. With respect to fair price, the court found that plaintiffs sufficiently alleged facts suggesting the units were worth more than the consideration received under the merger agreement. The court also found that plaintiffs sufficiently alleged facts suggesting the process approving the merger may not have been fair, including that America withheld material information, that America manipulated the alternatives to the merger to make it appear that the merger of the Company with America was the only choice and that it exerted influence over the consultants to the special committee that approved the merger. Accordingly, the court denied America's motion to dismiss.

With respect to the plaintiffs' claims against the defendant directors of the Company, the court focused on a provision in the Operating Agreement that provided that except as otherwise set forth therein, "none of the Directors, nor any other Indemnitee shall have any duties or liabilities, including fiduciary duties, to the Company or any Member." The court found that this language unambiguously eliminated the traditional fiduciary duties of the Company's directors and officers and that they were replaced by a duty of good faith on the directors and officers, where "good faith" was defined as an action believed to be in the best interest of the Company. The court noted that good faith under the Operating Agreement required a subjective analysis in contrast to the object standard under the common law. The plaintiffs argued that such a provision was unenforceable because it eliminated the implied covenant of good faith and fair dealing. The court rejected this position, however, holding that the Operating Agreement clearly imposed a subjective good faith standard on the directors and the court would not invoke an implied covenant to override these provisions. The court noted that although the plaintiffs may have stated a colorable claim for breach of the traditional fiduciary duties of care and loyalty, they did not allege the type of subjective bad faith required to state a claim under the standard set forth in the Operating Agreement and, therefore, the claims against the defendant directors were dismissed.

14. *Lonergan v. EPE Holdings LLC*, C.A. No. 5856-VCL (Del. Ch. Oct. 11, 2010)

Plaintiff, a holder of LP units in defendant Enterprise GP Holdings, L.P. ("Holdings"), sought to expedite the hearing on his application for a preliminary injunction to enjoin the merger of Holdings with a subsidiary of Enterprise Products Partners, L.P. ("EPD"). The court noted that a motion to expedite should only be granted if the plaintiff has articulated a sufficiently colorable claim and shown a sufficient possibility of a threatened

irreparable injury to justify imposing on the defendants and the public the extra costs of an expedited preliminary injunction proceeding. After reviewing each of the plaintiff's claims, the court concluded that the complaint failed to assert a sufficiently colorable claim.

EPD is, and Holdings was, a publicly-traded Delaware master limited partnership. Holdings controlled EPD through its one-hundred percent ownership of EPD's general partner. Distributions to Holdings unitholders derived primarily from Holdings' ownership of all the incentive distribution rights ("IDRs") in EPD. IDRs are a form of pay for performance whereby the percentage of cash received by holders of IDRs increases as distributions from the partnership increase. IDRs' claim to partnership cash flow, however, can reduce the trading price of LP units and thereby make such LP units a less attractive source of new money or acquisition currency.

To address the negative effect of the IDRs and implications arising from proposed federal tax legislation, EPD proposed the merger to the Holdings Audit, Conflicts and Governance Committee (the "Audit Committee"). As a result of the merger, Holdings LP units would be converted into EPD LP units, the IDRs would be cancelled, and control of EPD would remain essentially unchanged, with Holdings' general partner becoming general partner of EPD. The Audit Committee had full power to negotiate and accept or reject any deal. Over the course of two months of negotiations, the initial exchange ratio of 1.377 EPD units for each Holdings unit rose to 1.50. As part of the merger, EPCO, an affiliated entity and beneficial owner of seventy-six percent of Holdings LP units and twenty-seven percent of EPD LP units, also waived a percentage of distributions to which it was entitled for a period of five years following consummation of the transaction. After the Audit Committee's financial advisor opined that the transaction was fair from a financial perspective, the Audit Committee gave "Special Approval" for purposes of the Holdings LP agreement.

The court found that the Holdings LP agreement eliminated all fiduciary duties leaving only the contractual standards set forth therein and the implied covenant of good faith and fair dealing. The court also found that the complaint did not identify any provision of the Holdings LP agreement that the merger might violate, but rather relied solely on the implied covenant of good faith and fair dealing. Plaintiff's claims fell essentially into two categories: (1) *Revlon*-type claims alleging failure to seek an alternative transaction; and (2) *Lynch*-type claims insisting on majority-of-the-minority approval of the merger. But the court found that "plaintiff [sought] to cloak familiar breach of fiduciary duty theories in the guise of the implied covenant of good faith and fair dealing." The court rejected plaintiff's attempt to do so, concluding that "[t]o use the implied covenant to replicate fiduciary review would vitiate the limited reach of the concept of the implied duty of good faith and fair dealing."

The court further noted that section 7.9(a) of the Holdings LP agreement established "four alternative standards of review" to permit and approve conflict of interest transactions. Because the Holdings LP agreement set forth two other alternative methods of approval in addition to provisions contemplating majority-of-the-minority approval and *Revlon* best-offer-reasonably-available standards of review, the court concluded

section 7.9 disposed of plaintiff's claim that the implied covenant of good faith and fair dealing required compliance with either *Revlon* or *Lynch*.

Next, the court addressed plaintiff's claim that the implied covenant constrained the Special Approval process of the Audit Committee. To state a colorable claim under this theory, the court noted, the "plaintiff would need to allege particularized facts from which this Court could infer that the members of the Audit Committee acted arbitrarily or in bad faith." The court concluded plaintiff failed to do so. First, plaintiff did not challenge the disinterestedness or independence of the Audit Committee members. Second, the deal process, the terms negotiated by the Audit Committee, and the financial analyses conducted by the Audit Committee's financial advisor did not indicate arbitrary or bad faith conduct. Finally, section 7.10(b) of the Holdings LP agreement "conclusively presumed" action in reliance on an expert opinion, as was the case here, "to have been done . . . in good faith."

Finally, plaintiff also alleged defendants "violated the implied covenant of good faith and fair dealing by failing to disclose all material information reasonably available in connection with the LP unitholder vote." Ordinarily a general partner of a limited partnership owes fiduciary duties that include a duty of disclosure. Because the Holdings LP agreement eliminated all fiduciary duties, the court found that no fiduciary duty of disclosure remained. The complaint did not identify a contractual duty to disclose material information in connection with the merger, and the court refused to infer a disclosure obligation under the implied covenant of good faith and fair dealing. The court also found nothing inequitable about the level of disclosure provided (a meeting notice and a copy or summary of the merger agreement) and therefore concluded that this was not a situation where "compelling fairness" required it to invoke the implied covenant.

15. *Vila v. BVWebties LLC,* C.A. No. 4308-VCS (Del. Ch. Oct. 1, 2010)

Bob Vila, the well-known home improvement expert ("Vila"), and his friend, George Hill ("Hill"), entered into a joint venture called BVWebties LLC ("Webties") for the purpose of promoting Vila's website, BobVila.com. Webties' LLC Agreement provided that Vila and Hill were the managers, each owning 49% of Webties with the remaining 2% owned by a trust. The LLC Agreement required the consent of a majority of the managers for all decisions or actions to be made or taken. In order to promote BobVila.com, Webties entered into a licensing agreement with Vila that allowed Webties to use certain intellectual property owned by Vila. Either party could unilaterally terminate the licensing agreement at any time for any or no reason. In late 2007, after losing Webties' biggest advertiser and with the housing bubble about to burst, Vila and Hill began to disagree on the direction of Webties. The disagreement culminated in (a) a stalemate between Vila and Hill as to the strategic direction of Webties, (b) Vila's termination of the licensing agreement and a related suit by Hill in Massachusetts, and (c) Vila's initiation of the this action in the Court of Chancery seeking judicial dissolution of Webties under Section 18-802 of the LLC Act.

The court began by stating that in a judicial dissolution action, "the party seeking dissolution must prove by a preponderance of the evidence that he is (i) a member or manager, and (ii) that it is 'not reasonably practicable to carry on the business in conformity with a limited liability company agreement.'" Since it was clear that Vila was both a manager and a member of Webties, the court focused on whether it was no longer reasonably practicable to carry on the business of Webties in accordance with its LLC agreement. Vila advanced two arguments in support of judicial dissolution. First, he argued that since the purpose of Webties was to operate BobVila.com and Vila had terminated the licensing agreement with Webties, it was impossible for Webties to continue to perform its purpose. Second, he argued that the LLC agreement required both Vila and Hill, as managers of Webties, to consent to Webties' decisions and actions, and given that Vila and Hill could not agree on how to operate the business, no actions could be taken in accordance with Webties' LLC agreement.

The court stated that "[w]hen two coequal owners and managers whose mutual agreement is required for any company action are deadlocked as to the future direction and management of the enterprise and the LLC agreement provides no mechanism by which to break the deadlock, it is not reasonably practicable for the LLC to operate consistently with its operating agreement and a judicial dissolution will be ordered." The court analogized this situation to cases brought under DGCL Section 273, which sets forth the following three prerequisites for a judicial dissolution: (i) the corporation must have two 50% stockholders, (ii) those stockholders must be engaged in a joint venture, and (iii) those stockholders must be unable to agree upon whether to discontinue the business or how to dispose of its assets. The court found that Vila and Hill were deadlocked over serious managerial issues, including the strategic vision for and current operation of Webties and that the LLC agreement did not provide any alternative basis for resolving the deadlock. The court also found that Webties could not continue to operate in conformity the LLC agreement after Vila's termination of the licensing agreement. The court noted that this was not a case in which Vila in bad faith manufactured a phony deadlock, terminated the licensing agreement on short notice and sought dissolution so that he could take profits for himself that otherwise would have come to Webties. The court stated that "a business is not being operated in accordance with its governing instrument when one fiduciary acts as sole manager in a situation where the agreement of others is required." For these reasons, the court granted Vila's request for judicial dissolution of Webties.

Hill brought counterclaims alleging that Vila breached Webties' LLC agreement, breached the implied covenant of good faith and fair dealing and breached his fiduciary duties. The court found no basis for Hill's claims that Vila breached the LLC agreement. The court also denied Hill's claims that Vila breached the implied covenant of good faith and fair dealing. Hill argued that Vila breached the implied covenant by bringing the judicial dissolution action and refusing to accept supposed offers to purchase Webties. The court's denial was based on the fact that judicial dissolution is a remedy expressly contemplated by the LLC agreement and that Vila, as an equity owner, was under no contractual duty to consider selling his interest in Webties at a price that he viewed as suboptimal. Finally, the court dismissed Hill's fiduciary duty claims, finding them to

have arisen out of the same facts that formed the basis for Hill's breach of contract claims and thus to fail because they were superfluous.

16. *Ross Holding and Mgmt. Co. v. Advance Realty Group LLC*, C.A. No. 4113-VCN (Del. Ch. Sept. 2, 2010)

In this case, the court considered plaintiffs' request for the immediate appointment of a receiver based on the LLC's insolvency allegedly resulting from gross mismanagement and self-dealing by the defendant board. Defendants objected, both because neither the LLC agreement nor the LLC Act provided for the appointment of a receiver in case of insolvency and because plaintiffs failed to plead behavior sufficiently egregious to merit the appointment of a receiver in accordance with the court's equity powers.

Both parties acknowledged that the LLC Act, except as provided in Section 18-805 when the certificate of formation has been cancelled, is silent on the issue of the appointment of a receiver. Plaintiffs asserted that Section 291 of the Delaware General Corporation Law (the "DGCL"), which provides for the appointment of a receiver where a corporation is insolvent, should apply by analogy. Defendants, on the other hand, argued that the LLC Act's silence as to the appointment of a receiver in the context of insolvency demonstrated the legislature's intent to omit an analogous provision in the LLC Act. The court agreed with the defendants. Because Section 18-805 closely tracks Section 279 of the DGCL, the general provision establishing the process for appointing a receiver in the corporate context, the court held that the omission in the LLC Act of the provision for the appointment of a receiver in the case of insolvency was an intentional act by the legislature. Moreover, because the courts had developed standards for the appointment of a receiver long before the codification of Section 279 of the DGCL, the court found there was no obvious statutory gap in need of filling, as there was already a well-established equity standard for the appointment of a receiver.

According to the court, the appointment of a receiver is a drastic remedy that will not be "resorted to if milder measures will give the plaintiff . . . adequate protection for his rights." The court will only use its equitable powers to appoint a receiver "when fraud and gross mismanagement by corporate officers, causing real imminent danger of great loss, clearly appears, and cannot be otherwise prevented." A receiver will only be appointed "under special circumstances of great exigency," not simply where there have been errors of judgment in the management of a business. Plaintiffs alleged claims that fell within three principal categories, most of which involved allegations of self-dealing: (1) that the board transferred properties to companies affiliated with management for no consideration while continuing to guarantee underlying loans, (2) that the board allowed the company to default on certain loans while making unnecessary interest payments on loans owned to insiders, and (3) that the LLC, in a time of financial crisis, inappropriately compensated its senior management and provided millions of dollars to board members. After examining plaintiffs' allegations, the court stated that it could not conclude that plaintiffs had not asserted facts that, if true and accurate, would meet the high standard necessary to invoke the equitable remedy. Because material facts remained in dispute, the court held that a trial would be necessary and pending the outcome of such a trial, the court denied plaintiffs' motion for appointment of a receiver.

17. *Parkcentral Global, L.P. v. Brown Investment Mgmt., L.P.,* No. 288, 2010 (Del. Aug. 12, 2010)

This Delaware Supreme Court decision affirmed a ruling of the Court of Chancery that allowed a limited partner ("Brown") to demand a list of other limited partners in a hedge fund formed as a Delaware limited partnership ("Parkcentral"). Parkcentral's general partner had argued that, in addition to a prohibition in the partnership agreement, applicable law and Parkcentral's privacy policies (which stated that the "General Partner does not otherwise provide any non-public personal information about investors to outside firms, organizations or individuals, except as required by law") prohibited the disclosure of non-public information.

Under Section 17-305 of the Delaware Limited Partnership Act, limited partners are entitled to access to partnership information and records if they make a reasonable demand for a purpose reasonably related to their interest as a limited partner. As noted by the court, a general partner is permitted, under Sections17-305(a) and 17-305(f), respectively, to establish reasonable standards governing the right to access information and restrict the rights of a limited partner to obtain information. Section 9.1 of Parkcentral's partnership agreement mirrored the language of Section 17-305, permitting each partner, subject to Section 9.1(c) and reasonable standards established by the General Partner, to obtain certain records, including a current list of partners' names and addresses, upon reasonable demand. Section 9.1(c) provided that the General Partner could keep information confidential if it believed in good faith that disclosure was not in the best interest of the Partnership or if the General Partner was bound by law or agreement with a third party to keep such information confidential.

According to the court, Parkcentral could not cite to Section 9.1(c) as a reason to deny Brown access to also the partnership list. Not only did the court find that the general partner failed to demonstrate that it had a good faith belief that disclosure would harm the partnership, but also the court held that no third party agreement existed that required Parkcentral to keep such information confidential from the limited partners—rejecting the notion that each limited partner could be a "third party" in relation to the other limited partners.

Because the partnership agreement expressly granted limited partners the right to access a list of the names and address of each partner, the court held that Parkcentral could not deny Brown's request based on unilaterally issued privacy notices. According to the court, had the General Partner wished to completely bar access to the names and addresses of the partners, it could have done do explicitly in the partnership agreement.

The general partner also argued that the Gramm-Leach-Bliley Financial Modernization Act of 1999, which provides privacy protections for customers of financial institutions, pre-empted Delaware law and prohibited disclosure of the shareholder list to Brown. The privacy regulations, however, included an opt-out requirement whereby a financial institution may disclose non-public personal information in order to comply with state law. As such, the privacy regulations did not preclude Parkcentral from disclosing the list of limited partners' names and addresses to Brown.

18. *Forsythe v. ESC Fund Management Co. (U.S.), Inc.*, C.A. No. 1091-VCL (Del. Ch. Aug. 11, 2010)

In a further decision in this case relating to a dispute involving claims by the investors of an investment fund formed as a limited partnership (the "Fund"), the court addressed defendants' motion for summary judgment. Plaintiffs were current or former employees of Canadian Imperial Bank of Commerce ("CIBC") and limited partners in the Fund who brought a derivative action against the Fund, its corporate general partner, past and present directors of the general partner, the Fund's investment advisor and the Fund's special limited partner. The Fund was designed to "co-invest" with CIBC. Under this design, when CIBC's investment committee decided to make a particular investment on behalf of CIBC, the advisory board, which consisted of individuals who were the officers and directors of both the investment advisor and the special limited partner, would then decide if the investment met the Fund's eligibility requirements and, if so, invest along side CIBC.

Under the partnership agreement, none of the general partner, special limited partner or investment advisor would be liable for any act or omission "unless such act or omission resulted from bad faith, willful misconduct, gross negligence or a material breach of the [agreement]." Citing to *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 243 (Del. 2003), the court stated that a fiduciary will be found to have acted in bad faith if he "intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties." The court defined gross negligence as "conduct that constitutes reckless indifference or actions that are without the bounds of reason." (citing *McPadden v. Sidhu*, 964 A.2d 1262, 1274 (Del. Ch. 2008). The court found that there were material questions of fact as to whether the defendants acted in bad faith or with gross negligence. Not only did the court find that there were material questions of fact as to whether the advisory board even attempted to carry out its obligation to make determinations on behalf of the Fund from the perspective of the Fund and its limited partners rather than merely accept prior determinations by the CIBC's investment committee, but the court also found that there was little evidence that the general partner made any effort to oversee the Fund in order to properly discharge its continuing oversight obligation. The court affirmed a previous holding in the matter that, at minimum, the general partner retained "an active obligation . . . to take steps to satisfy itself that the Special Limited Partner and the Investment Advisor actually discharge[d] their delegated duties in compliance with the Partnership Agreement and in a manner loyal to the Partnership." (*Forsythe*, 2007 WL 2982247, at *7). While the court noted that independent director approval could ordinarily validate the actions of conflicted day-to-day decision-makers, the court stated that the evidence suggested that the general partner knew that the advisory board consisted of persons whose primary loyalty was to CIBC, rather than the Fund, and, if proven true, such evidence would eliminate the general partner's "ability to rely on the Individual Defendants as a cleansing device." The court stated that the outcome of the case would turn significantly on credibility determinations, but warned that a judgment rescinding the challenged transactions and restoring the Fund's capital plus interest (or awarding rescissory damages if rescission were impractical) appeared well within the range of possible remedies.

19. *Lola Cars Int'l. Ltd. v. Krohn Racing, LLC, et al.*, C. A. No. 4479-VCN; *Lola Care Int'l. Ltd. v. Krohn Racing, LLC, et al.*, C.A. No. 4886-VCN (Del. Ch. Aug. 2, 2010)

This post-trial decision "dealt with a business relationship gone awry." The case involved a joint venture named Proto-Auto, LLC, a Delaware LLC (the "Company"), which was formed by an English company ("Lola") and a Delaware LLC ("Krohn"). Lola held 51% of the interest in the company and Krohn held 49%, but the parties agreed to equal representation on the Company's board, with each party appointing one director. Krohn appointed Hazell as director of the Company and agreed to contribute Hazell's services as the Company's CEO. Hazell was also named as a defendant in this case.

Lola claimed that Hazell mismanaged the Company, thereby breaching his fiduciary duties of care and loyalty. As noted by the court, a manager of a Delaware LLC owes the LLC and its members the traditional fiduciary duties of care and loyalty; however, these duties may be contractually limited by agreement among the members. Because the members did not agree in the Company's operating agreement or otherwise to limit Hazell's fiduciary duties as the manager of the Company, the court found that Hazell was bound by the traditional duties of care and loyalty. Lola argued that Hazell's effort to challenge a recently amended design regulation constituted a violation of his duty of care. The court stated that to prove a claim for breach of duty of care, Lola needed to demonstrate that Hazell acted with gross negligence, which has been defined as "reckless indifference" or conduct beyond the "bounds of reason." The court determined that Lola failed to meet its burden. While Hazell had been advised that efforts to lobby for an exemption from the regulation were likely to fail, there were legitimate reasons for doing so. Lola also argued that Hazell's failure to sell any Company vehicles was motivated by his loyalty to Krohn. Not only did the court find that Hazell's lack of independence and potential conflicts were known from the outset, it also held that there was insufficient evidence to conclude that Hazell deliberately, or even recklessly, stunted the Company's sales efforts as a means of furthering Krohn's interests.

The court also addressed Lola's request for judicial dissolution. Under Section 18-802 of the LLC Act, upon "application by or for a member or manager the Court of Chancery may decree dissolution of a limited liability company whenever it is not reasonably practicable to carry on the business in conformity with a limited liability company agreement." The court stated that even if the high standard of "not reasonably practicable" is met, the decision to enter a decree of dissolution rests with the discretion of the court. The court stated that the exercise of its discretion in judicial dissolution cases has been guided, among other things, by: (1) whether there is deadlock between the members at the board level, (2) whether the operating agreement gives a means of navigating around the deadlock, and (3) whether, due to the company's financial position, there is still a business to operate." The court found that there was no deadlock among the members. While representation on the Company's board was split evenly between the members, management of the Company's daily business affairs was vested in Hazell, who could not be unilaterally removed. The court determined that the most significant fact, however, was the fact that the operating agreement contained a provision whereby the parties could resolve any deadlock. Under the deadlock procedure, if a dispute between the members remained unresolved for approximately one month, one member

(the "Terminator") had the right to offer a buyout price to the other member (the "Recipient"). The Recipient then had fifteen days in which to either accept the requirement to sell all of its interest to the Terminator or serve written notice upon the Terminator to require it to sell all of its interest to the Recipient at the same buyout price. According to the court, while it may have not been an ideal remedy for Lola's discontent with Hazell and Krohn, the deadlock procedure provided a method by which Lola could exit the business if it so chose. The court's determination that the deadlock procedure was a reasonable alternative for carrying on the business of the LLC stands in contrast to its holdings in both *Fisk Ventures, LLC v. Segal*, C.A. No. 2017-CC (Del. Ch. Jan. 13, 2009), and *Haley v. Talcott*, 864 A.2d 86 (Del. Ch. 2004). In *Fisk*, the court found it inequitable to force the petitioner to use its put right to exit its investment if it did not deem it to be in its best interest. Similarly, in *Haley*, the court found the exit mechanism to be an unreasonable alternative to carrying on the business of the LLC both because neither party wanted to leave the LLC and because the exit mechanism would not have provided for the removal of Haley as a personal guarantor of a mortgage on property owned by the LLC even though he would no longer have had any interest in the LLC.

The court in *Lola* concluded by emphasizing that a party to an operating agreement may not seek judicial dissolution as a means of freeing itself from what it considers to be a bad deal. As stated by the court, such a rule would unfairly permit one party to defeat the reasonable expectations of the other.

20. *PPF Safeguard, LLC v. BCR Safeguard Holding, LLC*, C.A. No. 4712-VCS (Del. Ch. July 29, 2010)

In this motion to dismiss, the court considered defendants' argument that plaintiff member's claims all implicated either a mandatory arbitration provision in the LLC agreement or a mandatory Louisiana forum selection provision in the key employment agreements. In addition to the foregoing two *provisions*, the agreements between the parties contained a third permissive forum clause for Delaware, but such provision did not require that any dispute be litigated in Delaware.

As stated by the court, "Delaware respects the contractual freedom of parties to enter arbitration agreements and will not allow a party to escape its promise to resolve claims by arbitration by filing in our courts." Because Delaware law favors the enforcement of arbitration clauses, the court stressed that Delaware courts "ordinarily resolve any doubts in favor of arbitration." Additionally, under Court of Chancery Rule 12(b)(3), Delaware courts will honor contractual choice of forum provisions where the parties "use express language clearly indicating that the forum selection clause excludes all other courts before which those parties could otherwise properly bring an action." Despite PPF's attempts to evade both the arbitration clause and the Louisiana forum selection clause, the court found that PPF's claims were based on interrelated allegations that implicated both clauses and, therefore, by contract, the bulk of PPF's claims must be either arbitrated or litigated in Louisiana. According to the court, "[t]he plaintiff is bound to honor its contractual promise and to press any of these claims in the mandated forums it freely selected." The court acknowledged the difficult task a Louisiana court or arbitrator would have in dividing up responsibility for hearing claims subject to the overlapping

dispute resolution provisions, but stated that it would be a disservice to the parties and to the interest of a justice system faced with limited resources for the court to further complicate such a task by failing to honor the primacy of those tribunals.

21. *Related Westpac LLC v. JER Snowmass LLC*, C.A. No. 5001-VCS (Del. Ch. July 23, 2010)

This case involves a suit between members of two LLCs formed to pursue a land development project in Snowmass, Colorado. When the funding needs of the project exceeded the agreed upon budget, plaintiff, the operating member of the LLCs, issued a capital call which defendant refused to meet. Defendant also refused to give its consent to a variety of major decisions. Under the operating agreements, defendant could not unreasonably withhold its consent to certain decisions. However, defendant argued that as to additional capital calls and the other matters at issue, it had contractually bargained to withhold its consent for any reason. Plaintiff sought to have the court (a) impose a reasonableness condition as part of the operating agreements' implied covenant of good faith and fair dealing and (b) find that defendant breached its fiduciary duty as a joint venturer by refusing unreasonably to fund capital calls and unreasonably withholding its consent to necessary transactions.

The court agreed with the defendant that under the LLC Agreements, it could withhold its consent for any reason as to the matters in dispute, and citing to *Nemec v. Shrader*, 991 A.2d1120, 1125-26 (Del. 2010), which provided that the implied covenant could not be used to "rewrite the contract to appease a party who later wishes to rewrite a contract he now believes to have been a bad deal," the court rejected plaintiff's request to imply a reasonableness requirement, as "[t]he express bargain of the parties covere[d] this subject and implying such an obligation would override their express bargain."

The court similarly rejected plaintiff's breach of fiduciary duty claim. According to the court, the parties to an operating agreement have the contractual freedom to structure the entity as they see fit. When the parties "cover a particular subject in an express manner, their contractual choice governs and cannot be supplanted by the application of inconsistent fiduciary duties that might otherwise apply as a default." To imply a fiduciary duty of reasonableness in these circumstances would nullify the parties' express bargain. The court cannot do that: "When a fiduciary duty claim is plainly inconsistent with the contractual bargain struck by parties to an LLC or other alternative entity agreement, the fiduciary duty claim must fall, otherwise 'the primacy of contract law over fiduciary law in matters involving contractual rights and obligations [would be undermined].'" (footnote omitted). Significantly, the court held that under the operating agreements, defendant had the contractual right to give or withhold its consent for a variety of major decisions as it chose, in its own commercial interest, and suggested that such a provision would allow defendant to secure a personal advantage as consideration for giving its consent.

22. *Milton Investments, LLC v. Lockwood Brothers, II, LLC,* C.A. No. 4909-VCC (Del. Ch. July 20, 2010)

This case involved disputes regarding an arbitration clause in an LLC agreement and the choice of an arbitrator. The parties entered into an LLC agreement that included an arbitration clause and selected a particular individual to arbitrate disputes that might arise. At the time the parties chose the arbitrator, both knew that the individual chosen had represented, or was representing, the other party. All conflicts were disclosed before the choice was made and both parties waived any conflicts of interest.

The court initially determined that the court, and not the arbitrator, had jurisdiction to determine the arbitrability of the claims. Next, the court found that the categories of arbitrable issues under the LLC agreement were very broad, and that all of the issues brought before the court fell within those categories.

The court then turned to the conflict of interest claim. Notwithstanding that both parties had previously waived the arbitrator's conflicts of interest, the plaintiff now claimed that the arbitrator was not impartial and argued that statements the arbitrator made before the arbitration indicated that we has biased against the plaintiff. Generally speaking, the court stated, arbitrators should be neutral and impartial, and parties normally agree on the necessity of these attributes. When partiality is evident, courts may be justified in vacating an arbitration award. However, the court noted that vacating an arbitration award on the basis that the arbitrator was not impartial requires that the parties appoint a neutral arbitrator. In this case, the court determined that even if the statements made by the arbitrator prior to the arbitration showed that he was incapable of neutrality (which they did not), the parties chose an arbitrator with known conflicts of interest, so neutrality of the arbitrator was not required in this case. Rather, the parties selected the particular individual precisely because both parties knew him well and had worked on previous projects with him. The court determined that by appointing an arbitrator with known conflicts of interest, the parties waived any argument to disqualification of the arbitrator on the basis that he had in the past, or was currently, representing either party.

23. *Hughes v. Kelly*, C.A. No. 4814-VCN (Del. Ch. June 30, 2010)

In this decision, the Court of Chancery addressed plaintiffs' motion to dismiss defendants' counterclaims in which defendants' sought to enforce indemnification, non-disparagement and release provisions in the LLC Agreement of Fund Administration Holdings, LLC, a Delaware limited liability company ("FAH"). In July 2002, FAH, a holding company that controlled International Fund Services (N.A.), LLC ("IFS"), sold IFS to State Street Bank and Trust Company ("State Street") in an asset sale transaction. One month prior to the sale, FAH's LLC Agreement had been amended to make defendant Kelly the managing member of FAH, thereby tasking Kelly with responsibility to distribute to FAH's members the proceeds of the sale. The sale agreement provided that part of the sale price was to be paid to FAH in a lump sum at closing, with the balance determined according to IFS's financial performance over the three year period following the sale. Under the sale agreement, Kelly was obligated to serve as CEO of IFS during the three year post-closing period and not to compete with IFS for two years

after termination of his employment with IFS. Each plaintiff was an FAH member, a senior IFS executive before the sale, and a State Street employee after the sale.

In 2005, Kelly made distributions to FAH members, setting aside approximately $5.5 million to cover potential tax or legal liabilities and other costs. Kelly resigned from IFS in August 2005 and started a competing business in 2007. In May 2008, State Street filed suit in New York alleging, inter alia, breach of the sale agreement's non-competition provision. After settling with State Street in June 2009, Kelly subsequently made a distribution to all FAH members other than plaintiffs, claiming he was entitled to the withheld amount as indemnification pursuant to the indemnification provision of FAH's LLC Agreement and that he could choose from which members to seek such indemnification. Plaintiffs filed this suit and Kelly counterclaimed, seeking a declaration that plaintiffs were responsible under the indemnification provision for costs associated with the New York action and this action, claiming breach of a non-disparagement provision in FAH's LLC Agreement based on plaintiffs' alleged role in inducing State Street to bring the New York action against Kelly, and seeking either a declaration that plaintiffs' claims fell within the release provision in FAH's LLC Agreement or specific performance of the release in the alternative.

FAH's LLC Agreement indemnified Kelly against claims "relating to or arising out of the activities of [FAH], or activities undertaken in connection with [FAH], or otherwise relating to or arising out of" the LLC Agreement except for "bad faith" acts. Plaintiffs argued that the indemnification provision was limited to Kelly's role as the managing member of FAH and did not apply to the conduct at issue in the New York action—namely, wrongful acts as CEO of IFS and immediately thereafter. Defendants argued that Kelly's position as CEO of IFS allowed him to maximize distributions to FAH members and therefore was inextricably intertwined with his role as managing member of FAH. The court framed the issue as "whether an indemnification clause that facially limits itself to one role of many held by an executive can be expanded to include actions taken in other roles that have some relation to that role subject to indemnification." Although the court was "skeptical" of defendants' "expansive reading" of the clause, it held that the indemnity clause was susceptible to two opposing, yet reasonable, interpretations and, as a result, it refused to grant plaintiffs' motion to dismiss under the applicable standard requiring that all reasonable inferences be drawn in favor of the non-moving party. The court likewise found that the ambiguities as to the scope of the indemnification clause also precluded dismissal of defendants' counterclaim for indemnification with respect to this action. Moreover, the court noted, assuming indemnification was not granted for the New York action, questions of fact might remain as to whether Kelly's reliance on a broad interpretation of the indemnification clause in withholding funds from plaintiffs constituted bad faith.

Under FAH's LLC Agreement, each member agreed, for a period of one year following the member's "Effective Termination Date," not to "engage in any conduct or make any statement disparaging or criticizing, or that could reasonably be expected to impair the reputation or goodwill of [FAH,] the Managing Member, . . . any of their respective Affiliates, or any products or services of these, in each case except to the extent required by law or legal process." Plaintiffs argued defendants' claim that they breached this

provision should be dismissed on a number of grounds. First, plaintiffs contended that criticism of Kelly in his capacity as CEO of IFS fell outside the scope of the provision. Because the LLC Agreement defined "Managing Member" as "James P. Kelly" but did not facially restrict the non-disparagement provision to his role as the FAH's managing member, the court found the clause to be ambiguous and therefore declined to dismiss defendants' counterclaim on this basis. Next, plaintiffs argued that the time period prescribed in the non-disparagement provision expired by the time of the New York action. The court rejected this argument, noting that because plaintiffs were still FAH members and IFS employees, their respective "Effective Termination Dates" had not yet occurred. Finally, plaintiffs contended that their disclosures were exempt under the provision's "legal process" exception. Plaintiffs argued that, under agency law principles, they were fiduciaries of State Street and therefore obligated to disclose relevant information that could affect the decisions of their principal. The court, however, concluded that plaintiffs failed to meet their burden of establishing that "legal process" should be read that expansively. The court also noted that inclusion of the word "required" suggested "mandated disclosure." Plaintiffs also attempted to take advantage of the absolute privilege afforded to trial witnesses, but the court declined to recognize such a privilege at this point in the litigation, noting that many factual questions were relevant to application of the privilege.

The release provision in FAH's LLC Agreement provided that each member released Kelly from all claims "relating to or arising out of the activities of [FAH], or activities undertaken in connection with [FAH], or otherwise relating to or arising out of" the LLC Agreement except for "bad faith" acts. Defendants argued that this clause required plaintiffs first to obtain a declaratory judgment that Kelly had acted in bad faith before plaintiffs could argue that the release clause did not apply to that conduct. The court, reading the LLC Agreement as a whole, declined to accept such a "hypertechnical approach" requiring a "two-stage litigation process in order to induce Kelly to carry out his primary obligations under the Agreement." The court therefore granted plaintiffs' motion to dismiss defendants' counterclaim based upon the release clause of the FAH LLC Agreement.

24. *Aris Multi-Strategy Fund, LP v. Southridge Partners, LP,* C.A. No. 5422-CC (Del. Ch. May 21, 2010)

Plaintiff, a limited partner of a Delaware limited partnership, filed an action under Section 17-305 of the LP Act seeking access to the partnership's books and records. The plaintiff argued that such action was not subject to arbitration under the partnership's limited partnership agreement. The arbitration provision of the partnership agreement provided, in relevant part, that "any claim or controversy arising among or between the parties hereto pertaining to the Partnership or this Agreement shall be settled by arbitration . . . ." The court held that the dispute was clearly a dispute "pertaining to the Partnership" and was thus subject to arbitration. The plaintiff also argued that inspection rights under 17-305 could not be determined by an arbitrator because Section 17-305(e) of the LP Act grants exclusive jurisdiction to the Court of Chancery for this type of dispute. Section 17-305(e) provides that the "Court of Chancery is hereby vested with exclusive jurisdiction to determine whether or not the person seeking such information is

entitled to the information sought." The court disagreed, finding that Section 17-109(d) permits a limited partner to waive its right to bring actions "relating to the organization or internal affairs of a limited partnership" in the Delaware courts so long as it does so by agreeing to arbitrate such actions.

25. *Brown Investment Mgmt., L.P. v. Parkcentral Global, L.P.,* C.A. No. 5248-VCL (Del. Ch. May 20, 2010)

This case was before the court on a motion to stay pending appeal. At trial, the Court ordered the defendant partnership to produce a list of other limited partners to the limited partner plaintiff. The defendant requested a stay of the order pending appeal of the Vice Chancellor's decision, arguing that the Gramm-Leach-Bliley Act of 1999 pre-empted 6 *Del. C.* § 18-305, and thus, the defendant could not turn over the list. Citing *Arbor Place L.P. v. Encore Opportunity Fund, L.L.C.,* (Del. Ch. Jan. 29, 2002) the Vice Chancellor found that (i) such a rule would negate a core right provided by Delaware law, and (ii) the defendant did nothing to provide for confidentiality of its investor list other than to issue the periodic privacy notices required under Gramm-Leach-Bliley. Based on the above, and the fact that the defendant could not show that providing the list would harm the partnership, the Vice Chancellor denied the motion to stay.

26. *Borin v. Rasta Thomas LLC*, C.A. No. 5344-CC (Del. Ch. May 4, 2010)

In this decision, the Court of Chancery addressed a motion by defendants to alter or amend an earlier judgment by the court in an action arising out of the repurchase by Rasta Thomas LLC (the "Company") of a member's 40% interest in the Company. Under the repurchase agreement, the member received payments characterized as "closing date cash consideration," "unpaid annual salary," and "return of capital contribution," which were collectively characterized as the "purchase price," at the December, 2009 closing of the repurchase. The Company's LLC Agreement provided that 40% of the Company's income would be allocated to the member for tax reporting purposes and also provided that the Company would make a tax distribution of 35% of the income allocated to the member so that the member could pay her taxes. After the closing of the repurchase, the member received a Schedule K-1 from the Company which reflected the allocation to the member of $184,306 of the Company's income for 2009. The member requested a tax distribution from the Company of 35% of such amount and when the Company failed to make such tax distribution, the member initiated this action.

Defendants argued at trial that the Company did not have to pay the member a tax distribution because the LLC Agreement was superseded by the repurchase agreement. The court disagreed, finding that it was inconsistent for defendants' to treat the LLC Agreement as binding on the parties for purposes of allocating income to the member while simultaneously treating it as superseded and not binding for purposes of making the tax distribution tied to the income allocation. Defendants argued that the court's judgment would result in a windfall to the member, which would be manifestly unjust. The court found that the payments to the member under the repurchase agreement were not intended to satisfy the Company's tax distribution obligation and therefore denied defendants' motion.

27. *Ross Holding and Mgmt. Co. v. Advance Realty Group, LLC*, C.A. No. 4113-VCN (Del. Ch. Apr. 28, 2010)

The court was presented with a motion by a defendant foreign corporation to dismiss a complaint for lack of personal jurisdiction. The plaintiffs were unit holders of the Delaware limited liability company at the center of the dispute and alleged that the defendant breached certain fiduciary duties owed to them. The defendant invested in the LLC through a separate entity (the "Investment Fund") pursuant to a credit agreement and a promissory note which was convertible to equity and which permitted the Investment Fund to select two of the four members of the board of the LLC. The plaintiffs asserted that the defendant, through the two board members it indirectly controlled, controlled the LLC to its benefit and to their detriment. The defendant allegedly had no physical presence in Delaware. The plaintiffs sought jurisdiction under Section 18-109 of the LLC Act. The defendant argued that it did not fall within the definition of "manager" under Section 18-109 of the LLC Act because (i) the LLC was managed by a board (and it was not directly a board member), (ii) the Investment Fund, and not the defendant, had the right to designate board members and (iii) the mere act of selecting management is insufficient to constitute management. The court observed that what constitutes material participation in the management of an LLC is an open question, that the LLC Act does not provide much guidance and that Delaware case law is only marginally more helpful. The court noted that simply conferring with members of management on occasion and being involved in a single issue has been found not to constitute material participation in management. However, the court concluded that additional discovery would be necessary to decide this issue because of the uncertainty of the defendant's role in the management of the LLC.

28. *Orix v. Inscap Asset Management, LLC*, C.A. No. 5063-VCS (Apr. 13, 2010)

This case examined the issue of substantive arbitrability: namely, whether it is for the court or an arbitrator to decide if a claim is subject to arbitration. The matter involved a dispute between defendants, Life Insurance Fund LLC (the "Fund") and its management, and two of the Fund's investors, Orix LF, LP ("Orix") and Swiss Re Financial Products Corporation ("Swiss Re"). Orix sought to enjoin defendants' arbitration claims because defendants failed to obtain Swiss Re's consent to such an action, which Orix claimed was required under one of the contracts (the "ISM Agreement") that the parties executed in conjunction with the formation of the Fund. Defendants, however, argued that their claims were properly committed to arbitration under a second contract (the "Fund Agreement"), which contained a broad arbitration clause. The ISM Agreement both contained a merger clause and specifically referenced the Fund Agreement; thus, the Fund Agreement and the ISM Agreement together embodied the entire agreement of the parties. While the ISM Agreement did not contain an arbitration provision, the notice provision contemplated service of process upon the parties in connection with arbitrations.

For questions of substantive arbitrability, the presumption is for the court, not the arbitrator, to decide unless, as the Supreme Court held in *James & Jackson, LLC v. Willie Gary, LLC*, 906 A.2d 76 (Del. 2006), there is "clear and unmistakable evidence that the

parties intended otherwise." In the absence of a statement that the arbitrator should decide the issue of substantive arbitrability, the *Willie Gary* standard is satisfied when (1) the contract generally refers all disputes to arbitration and (2) the contract refers to a set of rules that would empower arbitrators to decide arbitrability. The Fund Agreement met this standard, as it provided that "any dispute" arising out of or relating to the Fund Agreement was to be arbitrated and such arbitration would proceed under the rules of the AAA.

Additionally, Orix argued that defendants sought to cast disputes related solely to the ISM Agreement as ones arising under the Fund Agreement. The court held, however, that even if that were the case, the broad "relating to" language in the arbitration clause encompassed such disputes, especially when considered in connection with the fact that (1) the two agreements were executed on the same day, (2) the ISM Agreement contained a merger clause, (3) the ISM Agreement expressly referred to the Fund Agreement as the "Operating Agreement" and (4) the ISM Agreement provided for service of process for arbitrations. Further, as the court held in *McLaughlin v. McCann*, 942 A.2d 616 (Del. Ch. 2008), "absent a clear showing that the party desiring arbitration has essentially no non-frivolous argument about substantive arbitrability to make before the arbitrator, the court should require the signatory to address its arguments against arbitrability to the arbitrator."

Finally, any procedural question regarding whether the Fund could initiate proceedings against Orix and Swiss Re without Swiss Re's consent was for the arbitrator, and not the court, to answer.

29. *Harris v. RHH Partners, LP*, C.A. No. 1198-VCN (Del. Ch. Mar. 30, 2010)

In a subsequent decision in a case in which the Chancery Court had ordered the judicial dissolution of a Delaware limited partnership (see Sections II.C and II.G), the court addressed a motion for reargument by the general partner of the partnership. In its prior decision, the court found that the general partner had failed to make a $1,000 capital contribution required under the partnership agreement and thus held that the general partner's liquidating distribution in the partnership would be offset by a $1,000 charge. The general partner argued in his motion that the reference in the introductory language of the partnership agreement to the receipt of "mutual covenants . . . and other valuable consideration" relieved the general partner of any obligation to make a capital contribution pursuant to a subsequent provision of the partnership agreement.

The court denied the general partner's motion, interpreting the introductory language of the partnership agreement to refer "either to the mutual promises exchanged between the general partner and the limited partner or to some other valuable consideration tendered at the time of formation." According to the court, there was no indication that the introductory paragraph addressed the substance of a subsequent provision of the partnership agreement stating that the general partner "shall contribute" $1000. The court noted that, in this context, "shall" had "both future and mandatory aspects" and as a result, if the contribution had been made, the text of the contribution provision would have (or at least should have) been different. The court also noted there was

"overwhelming evidence" that the general partner had not made the capital contribution. The general partner's motion was thus denied.

30. *Kuroda v. SPJS Holdings, L.L.C.*, C.A. No. 4030-CC (Del. Ch. Mar. 16, 2010)

Following the court's dismissal in an earlier decision of the bulk of plaintiff's claims (*see Kuroda v. SPJS Holdings, L.L.C.*, C.A. No. 4030-CC (Del. Ch. Apr. 15, 2009), defendants filed counterclaims against plaintiff for: (a) breach of fiduciary duty, (b) breach of contract and (c) breach of implied covenant of good faith and fair dealing. Defendants had formed two investment funds: the Feeder Fund and the Master Fund (collectively, the "Funds"). The Master Fund served as the principal investment vehicle for making investments in strategically targeted Japanese companies and the Feeder Fund was structured to serve as a vehicle for U.S. investors to invest in the Master Fund. Plaintiff was a member of defendant SPJS Holdings, L.L.C., a Delaware limited liability company ("SPJS"), which was created to serve as the Funds' general partner. Steel Partners Japan Asset Management ("SPJAM") served as the Funds' investment manager, while Steel Partners Japan, K.K. ("SPJ-KK"), a corporation in which plaintiff was a 50% shareholder, consulted with SPJAM in connection with its role as investment manager. Plaintiff had no experience managing investments or operating an investment fund, but had spent time evaluating Japanese companies and developing acquisition strategies for senior Japanese executives. As such, he worked as a trusted consultant to the Funds' investment manager. Because of disagreements with his fellow members, plaintiff decided to withdraw from SPJS. Upon his departure, plaintiff launched a fund that competed directly with the Funds. Defendants alleged, among other things, that plaintiff misappropriated confidential investor lists, unlawfully used confidential trade secret information and hired away employees.

In the breach of fiduciary duty claim, defendants asserted that plaintiff violated fiduciary duties that arose both from the terms of a consulting agreement between SPJAM and SPJ-KK and from his role at SPJS and in the overall structure of the investment endeavor. The court found that the argument that plaintiff had assumed the role of a fiduciary by virtue of his "central role" in the LLC agreement was entirely baseless, as he was a non-managing member who had no control, power or authority over a single investor's assets or any actions taken by SPJS. Plaintiff's only duties were contractual, not fiduciary. As such, the court granted plaintiff's motion to dismiss the claim for breach of fiduciary duty.

In the breach of contract claim, defendants asserted that plaintiff violated provisions of the Funds' operating agreements that prohibited the disclosure of trade secrets and other proprietary information relating to the Funds. Plaintiff argued that because he was not a party to either operating agreement he could not be bound by any of their provisions, including the confidentiality provisions. Defendants, however, sought an exception to the rule that a non-signatory to an agreement will not be bound by it, arguing that plaintiff had implicitly adopted the contract when he accepted the benefits of the operating agreements. The court rejected defendants' implied-adoption argument, stating that a non-managing member of SPJS could not be bound to an agreement signed by SPJS, and dismissed the claim for breach of contract.

As to the breach of the implied covenant of good faith and fair dealing, defendants argued that plaintiff impliedly promised (1) not to misappropriate trade secrets, (2) not to cause SPJ-KK to commit a material breach of the consulting agreement's confidentiality provisions, (3) not to commit a material breach of the Fund's operating agreements' confidentiality provisions, (4) not to cause SPJS to commit a material breach of the Fund's operating agreements' confidentiality provisions, and (5) not to engage in conduct destructive to the business of SPJS and the Funds. The court refused to apply the implied covenant of good faith and fair dealing to impose upon plaintiff a duty of confidentiality under the SPJS operating agreement. Relying on *Dunlap v. State Farm Fire & Cas. Co.*, 878 A.2d 434 (Del. 2005), the court explained that the implied covenant of good faith and fair dealing requires a party in a contractual relationship to refrain from arbitrary or unreasonable conduct which has the effect of preventing the other party to the contract from receiving the fruits of the bargain. To successfully invoke the implied covenant, one must allege a specific implied contractual obligation and allege how the violation of that obligation denied him the fruits of the contract. In this case, the SPJS operating agreement specifically excluded any duties relating to confidentiality, while other agreements, including the consulting agreement, did not. As such, there was no specific implied contractual obligation of confidentiality that plaintiff could have breached. The court, therefore, dismissed the claim for breach of the implied covenant of good faith and fair dealing.

31. *Sunrise Ventures, LLC v. Rehoboth Canal Ventures, LLC,* C.A. No. 4119-VCS (Del. Ch. Mar. 4, 2010)

This case was before the court on a motion for reargument. The plaintiffs argued that dismissal had been unwarranted for two reasons: First, because the contract over which the dispute centered was executed under seal (and, thus, the statute of limitations had not expired); and, second, because the parties were engaged in a joint venture before the disputed contract was executed (therefore the defendant owed the plaintiff fiduciary duties).

The court dismissed the plaintiff's first argument because it had failed to raise the argument at any point prior to its motion for reargument. However, the court went on to clarify that the word "SEAL" must appear alongside each signature line in order to reap the benefit of the twenty year statute of limitations associated with contracts under seal. In this case, the word "SEAL" did not appear next to the signatures. Rather, the contract included a lead-in to the signatures which said "IN WITNESS WHEREOF, the parties have set their Hand and Seal as of the day of the year first written above." The court ruled that this statement (without the word "SEAL" opposite the signatures) was not sufficient to provide for a twenty year statute of limitations.

With respect to the plaintiff's second argument, the court listed the factors that must be present for a joint venture to be created: (1) a community of interest in the performance of a common purpose, (2) joint control or right of control, (3) a joint proprietary interest in the subject matter, (4) a right to share in the profits, and (5) a duty to share in the losses which may be sustained. These factors did not exist prior to the signing of the contract, therefore the court determined that the parties were not engaged in a joint venture before

entering into the contract. Instead, the parties were only in negotiations over how and whether to enter into an agreement. The court denied the plaintiff's motion for reargument.

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