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2013 Annual Review of LLC Case Law Developments

2013 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. *Zimmerman v. Crothall,* C.A. No. 6001-VCP (Del. Ch. Mar. 5, 2012 and Jan. 31, 2013) (V.C. Parsons)

Plaintiff claimed that certain issuances of preferred units and convertible debt were self-interested transactions in Adhezion Biomedical LLC, a Delaware limited liability company ("Adhezion"), benefitted certain of the current directors and the VC Investors (as defined below) and unfairly diluted the common members. Plaintiff argued that the directors' actions violated the duty of care and the duty of loyalty and breached the LLC Agreement by authorizing additional units of existing series of units and creating a new series of units without the approval of a majority of the common members. The defendants included directors of Adhezion and certain venture capital investors in Adhezion (the "VC Investors"). This case was before the court on the defendant's motion for summary judgment.

The court granted the defendants' motion for summary judgment on the plaintiff's breach of the duty of care claim. The defendants argued that the LLC Agreement limited the directors' liability to only breaches of the duty of loyalty. However, the court found that the use of the word "recklessness" in the list of behavioral descriptors that were grounds for damages was equivalent to "gross negligence," and therefore the LLC Agreement implicated the duty of care. Nevertheless, the court found that the defendants' conduct did not amount to gross negligence because the board's actions were properly viewed through the business judgment rule. In order to overcome the applicability of the business judgment rule, the plaintiff needed to prove that the board's decision making process showed a "reckless indifference to or a deliberate disregard of the whole body of stockholders or actions which are without the bounds of reason." The court noted that this is an onerous standard and determined that the plaintiff was unable to show that the board's process was reckless. To the contrary, Adhezion needed capital and the board contacted over 40 potential investors, entering into serious discussions with a few. Although the board ultimately decided to raise capital from current investors, the defendants showed that the board received updates on the financial condition of Adhezion and discussed different financing options.

With respect to the plaintiff's breach of the duty of loyalty claim, the plaintiff alleged that the directors approved self-dealing transactions in bad faith, that they were standing on both sides of the transactions, and therefore, the entire fairness analysis should be applied. In order to prove a claim of bad faith, the court said that the plaintiff needed to show that the "board's decision was so egregious or irrational that it could not have been based on a valid assessment of the corporation's best interests." Also, the court noted that an intentional dereliction of a known duty is higher than a standard of recklessness. The court granted the defendant's motion for summary judgment on the plaintiff's bad faith claim for the same reasons it granted the motion on the breach of duty of care claims.

With respect to his claim of self-dealing, the plaintiff argued that the transactions entered into by Adhezion were self-dealing because a majority of the directors that approved the transactions were "standing on both sides" of the transactions and also because the VC Investors constituted a control group which also stood on both sides of the transactions.

The court denied the motion for summary judgment on the claim that the VC Investors were a control group. A shareholder is "controlling" if it owns a majority interest or it exercises actual control over the board (actual control can be shown if the shareholder (or group) holds such power that it is similarly situated as if it had a majority interest). On the one hand, the court noted that it is very difficult to show that a shareholder is a "controlling shareholder." On the other hand, the VC Investors together held 66% of the voting shares and at least two of the five directors' seats. Furthermore, both were early stage investors and there were communications of the defendants that tended to show the VC Investors had considerable pull in the actions the board decided to pursue. Turning to the plaintiff's claim that a majority of the board was interested, the court determined that out of the five directors, two participated in the transactions individually and another was the managing partner of one of the VC Investors. Therefore, it was possible that the plaintiff could show a majority of the board was interested.

In addition to showing that the majority of the board was interested or that the VC Investors were a control group, the plaintiff also needed to show that those on both sides of the transaction received a benefit exclusive to them. The transaction that took place in 2009 was not open to all current unitholders of Adhezion. The defendants argued that it did not matter because the offering price was consistent with the price in other recent transactions. However, the plaintiff's claim was that the issuance took place at a price that was improperly low and, therefore, the overall value of Adhezion was diluted. In light of the plaintiff's claim, the court determined that the fact that the price was similar to other recent prices at the time did not warrant granting summary judgment. The court denied the defendants' request for summary judgment on the plaintiff's self-dealing claim with respect to the 2009 transaction because it was possible that it was subject to the entire fairness standard, and whether it passed such scrutiny could not be determined without expert valuations. The other transactions complained of did not treat all unitholders equally in that the defendants were given the opportunity to subscribe for the new interests first, with the leftovers (if any) available to be purchased by the common members. Based on this structure, the court determined that the transactions that took place in 2010 and 2011 conferred an exclusive benefit on the defendants because they were given the opportunity to participate first and fully in the additional offerings. Although the court noted that there is no inherent right against dilution in Delaware law, the structure of the transactions conferred an exclusive benefit on the defendants. The court denied summary judgment and in fact determined that the 2010 and 2011 transactions were self-dealing and subject to entire fairness review.

Two of the five directors on the board of Adhezion were allegedly independent and disinterested. The LLC Agreement included a safe harbor provision that the court found might have overridden the entire fairness review in the situation. The safe harbor provision closely tracked 8 *Del. C.* § 144 and the defendants argued that it entitled them to have the transactions at issue reviewed under the business judgment rule. However, the plaintiff argued that the safe harbor provision did not address monetary damages and only rendered a transaction itself not void or voidable solely because it was an interested transaction. The court sided with the plaintiff on this issue. The plaintiff also argued that the defendants had not satisfied the safe harbor provision anyway, citing reasons such as the VC Investors being a control group and the transactions being taken in bad faith. The

court dismissed the defendants' motion for summary judgment in accordance with its earlier discussion regarding the VC Investors being a control group and granted it on the plaintiff's bad faith arguments.

Turning to the plaintiff's aiding and abetting claim, the court note that in order to prevail on such a claim, the plaintiff needed to show the underlying breach of fiduciary duty. Therefore the court granted the defendants' motion for summary judgment with respect to the aiding and abetting claims regarding a breach of the duty of care. The court denied the motion with respect to the aiding and abetting claims based on the alleged breach of the duty of loyalty. Furthermore, the court granted the motion for summary judgment of the aiding and abetting claims based on a breach of contract, noting that there is no cause of action for aiding and abetting a breach of contract under Delaware law.

Finally, the plaintiff claimed that the defendants breached the amendment provisions of the LLC Agreement by creating a new preferred series of units without the consent of a majority of the common members. The LLC Agreement provided that amendments required the vote of a majority in interest of the common members. The only exception was "as otherwise provided in Section 3.8…with respect to the issuance of additional Units." Section 3.8 of the LLC Agreement provided that the board could "issue additional units…or create additional classes or series of units…." The defendants claimed that Section 3.8 gave the board a "blank check" to create, authorize and issue new units. Conversely, the plaintiff argued that "create" in Section 3.8 should be construed more narrowly, and, more importantly in the court's view, that the exception to the majority in interest of common members rule only spoke to issuance of additional units (and not the creation of a new series of units). The court determined that the language of the LLC Agreement in this situation was ambiguous, and therefore denied the defendants' motion for summary judgment on the breach of contract claim.

In its subsequent post-trial opinion, the court addressed the plaintiff's claims alleging breach of the LLC Agreement, breach of the duty of loyalty by the directors and the VC Investors and aiding and abetting of the directors' breach of the duty of loyalty as well as the plaintiff's requests for reformation and repayment of attorney's fees advanced by Adhezion to the defendants.

The court first turned to the breach of contract claim, which centered on whether the LLC Agreement required the approval of common unitholders (1) to increase the number of units Adhezion was authorized to issue and (2) to create additional classes or series of units. The court noted that the LLC Agreement used three terms with commonly-understood meanings in the corporate context: "create," "authorize" and "issue."

With respect to the approval required to authorize additional units, the defendants argued that the power to increase the number of authorized units was merely incidental to the Board's ability to create and issue units under the LLC Agreement and to unilaterally amend the LLC Agreement in connection therewith. The court disagreed with this argument. Relying on testimony of the attorney that drafted the LLC Agreement and noting that the LLC Agreement gave certain unitholders veto rights in connection with the authorization of units while providing the board with the power only to create and

issue units, the court concluded that the use of "authorize" in the LLC Agreement was deliberate and additional units must therefore be authorized. Regarding the procedures necessary to authorize additional units, the court found that because the LLC Agreement was silent on the steps necessary to authorize additional units, the most reasonable interpretation was that the parties intended the LLC Agreement to be amended to accomplish the authorization of units. The court next considered what was required to amend the LLC Agreement. The LLC Agreement required unitholder approval, including common unitholder approval, of all amendments except with respect to the "issuance" of additional units pursuant to provisions of the LLC Agreement that authorized the board to "create" and "issue" additional units. The parties disputed the scope of the amendment exception and whether authorization of additional units fell within the exception. The court, reading the LLC Agreement as a whole, held that regardless of whether the board could unilaterally create or issue additional units, it clearly could not authorize additional units without obtaining the unitholder consent required by the LLC Agreement's amendment provision.

Next, the plaintiff contended that the LLC Agreement required common unitholder approval to create additional series or classes of units because the exception to the LLC Agreement's amendment provision referred only to "issuance" of units pursuant to provisions of the LLC Agreement that authorized the board both to "create" and "issue" additional units. The court concluded the LLC Agreement to be ambiguous on this point and therefore turned to extrinsic evidence. The court noted that at all relevant times, the amendment exception referred only to "issuance" of units, even when the section of the LLC Agreement cross-referenced in the exception gave the board the power only to "create" additional series or classes of units. The LLC Agreement was later amended to authorize the board to "create and "issue" additional series or classes of units. The court therefore declined to interpret the language of the amendment exception as limiting and instead found that the exception broadly referred to the subject matter of the cross-referenced section-namely, the "creation" and "issuance" of additional series or classes of units.

Having concluded that common unitholder approval was required to increase the number of authorized units but not to create additional series or classes of units, the court turned to whether the directors breached the LLC Agreement in connection with the challenged issuances. The court held that the directors breached the LLC Agreement because the directors had purported (1) to increase the number of authorized shares without obtaining the requisite unitholder consent and (2) to issue units that, although created in accordance with the provisions of the LLC Agreement, had not been properly authorized.

In reaching its conclusion on the breach the LLC Agreement, the court noted that it is incumbent upon parties to an LLC Agreement to manifest their intent to deviate from the meaning that a reasonable investor would attribute to a term. The court therefore rejected the strained meaning of the familiar corporate law term "authorize" that the defendants advocated. The court also found the facts of this case supported application of the rule of *contra proferentum*, which requires that ambiguous contract terms be construed against the drafter. Specifically, the court concluded that the plaintiff reasonably understood the use of the term "authorize" in the LLC Agreement to place a limit on the level of dilution

he faced subject to his consent, in his capacity as a common unitholder, to increase such dilution.

The court next addressed the plaintiff's claim of breach of the duty of loyalty. The plaintiff alleged breach of the duty of loyalty by the directors and by two unitholders that allegedly controlled Adhezion. The court first turned to plaintiff's claim against the unitholders. Because neither unitholder alone possessed the voting power to control Adhezion, the plaintiff needed to show that the unitholders acted together to exert control over the company. The court concluded that the plaintiff failed to allege facts demonstrating a concerted effort by the unitholders to control Adhezion.

In connection with its analysis of breach of the duty of loyalty by the directors, the court reviewed the LLC Agreement to determine what provisions, if any, addressed fiduciary duties. The court concluded that the LLC Agreement defined the scope of director fiduciary duties in two ways: first, by setting a general standard for fiduciary conduct and, second, by giving the directors the right to engage in conflicted transactions subject to certain requirements.

Having determined the scope of the duties owed by the directors, the court noted that it must determine the applicable standard of review and the party that bears the burden of proof. The provisions of the LLC Agreement pertaining to conflicted transactions gave directors the right to engage in a conflicted transaction provided that the payments made by Adhezion were "comparable to the payments or fees that would be paid to unrelated third parties providing the same property, goods, or services" to Adhezion. In addition, the LLC Agreement provided that a conflicted transaction would not be deemed void or voidable if the transaction was "fair" to Adhezion at the time it was authorized. The court noted that Delaware courts have interpreted similar provisions as effectively calling for review under the entire fairness standard, which requires a showing of a fair process and a fair price.

The court then addressed the question of which party must demonstrate that there was a fair process and a fair price. The court first noted that in the corporate context, or where default fiduciary duties are applicable in the LLC context, director-defendants bear the burden of proving that a transaction is entirely fair. The duties in this case, however, were set forth in the LLC Agreement and therefore contractual in nature. Focusing on the LLC Agreement provision requiring conflicted transactions to be on terms comparable to unrelated third party transactions—i.e., entirely fair—the court held that the plaintiff had the burden of proving a breach of the contractual requirement that the challenged transactions be entirely fair. The court recognized, however, that other provisions of the LLC Agreement pertaining to conflicted transactions rendered its conclusion not free from doubt. These other provisions deemed conflicted transactions not to be void or voidable if certain requirements were met. The court noted that it was unclear whether qualifying under one of these safe harbor provisions would trigger review under the business judgment rule or shift the burden to the party challenging the transaction. The court concluded that its approach of allocating to the plaintiff the burden to prove entire fairness harmonized all provisions of the LLC Agreement pertaining to conflicted transactions. According to the court, if the directors had the burden to prove entire

fairness then one of the safe harbors, which deemed a transaction not to be void or voidable if it was fair to the company at the time it was authorized, would be redundant.

In connection with its discussion of the burden of proof, the court distinguished the conflicted transaction LLC Agreement provision at issue here with a similar provision interpreted by the Delaware Supreme Court in the recent Auriga case. The relevant LLC agreement provision in Auriga provided that members or managers could not, without the required consent, cause the company to enter into a conflicted transaction on terms less favorable than terms obtainable in an arm's length transaction. The Supreme Court concluded that under this provision the defendants had the burden to prove the entire fairness of the challenged transaction. In contrast, the court noted that Adhezion's LLC Agreement gave directors the affirmative right to enter into a conflicted transaction so long as the terms of such transaction were comparable to terms of unrelated third party transactions. The court also noted that dicta in the Supreme Court's Auriga decision indicated that compliance with one of the LLC Agreement's safe harbor provisions may trigger application of the business judgment rule. Specifically, in Auriga, the Supreme Court stated that if the transaction at issue had been conditioned on approval by an informed majority of nonaffiliated members as required by the LLC agreement, it would not have been reviewed under the contractual entire fairness standard and the Supreme Court contrasted such a result with the usual outcome of shifting the burden to prove entire fairness in the corporate law context.

The court concluded that the directors complied with one of the safe harbors: good faith approval of the challenged transaction by disinterested directors with knowledge of the material facts. According to the court, at least two of the directors were disinterested and both approved the challenged transactions. As a result, the court found that the directors should arguably receive the benefit of the business judgment rule or, at a minimum, the burden to demonstrate entire fairness should shift to the plaintiff, assuming the plaintiff did not already bear such burden.

Having addressed what standard of review applied and which party had the burden of proof, the court turned to the issue of whether the challenged transactions were entirely fair. The court noted that although its analysis assumed that the plaintiff had the burden to prove entire fairness, the facts of this case were sufficiently strong regardless of which party had the burden. Turning to the factual evidence, the court noted that at the time of each of the challenged transactions, Adhezion needed money to continue its business. Adhezion was a risky investment because of threatened patent litigation, lack of a strategic partner and a market dominated by a single competitor. Adhezion had solicited further outside investment without success and had considered offers to purchase that included a limited amount of cash up front. The court also found the defendants' expert witness' testimony regarding fairness of the transactions and the value of Adhezion to be more credible. As a result, the court concluded that, regardless of which party had the burden to prove the entire fairness of the challenged transactions, the transactions were entirely fair and the directors therefore had not breached the duty of loyalty. The court further noted that because there had been no breach of fiduciary duty the plaintiff's aiding and abetting claim could not succeed.

The court next turned to the issue of the remedy for the directors' breach of the LLC Agreement. The plaintiff requested reformation of the terms of the challenged transactions. Specifically, the plaintiff asked the court to cancel all warrants and certain options that were issued and to deem promissory notes to have been issued instead of units. The court refused to grant the plaintiff's request. The court noted that Adhezion needed cash at the time of the challenged transactions and received cash on fair terms. Moreover, the relief requested would create a windfall for the plaintiff. As a result, the court declined to award damages beyond nominal damages of one dollar.

Finally, the court turned to the plaintiff's request to require the defendants to reimburse Adhezion for legal fees advanced to the defendants. The court found that the directors were entitled to indemnification under the terms of the LLC Agreement and that the non-director defendants were entitled to indemnification under the terms of a purchase agreement entered into in connection with one of the challenged transactions. As a result, the court concluded, whether the defendants were also entitled to advancement was largely moot at this advanced stage of the proceeding. Moreover, the court noted that although the LLC Agreement did not expressly address advancement, it gave the directors broad authority to make decisions and take actions not otherwise provided for in the LLC Agreement. The court concluded that the directors therefore had authority to approve advancement of the defendants' legal fees.

2. *In re Mobilactive Media LLC*, C.A. No. 5725-VCP (Del. Ch. Jan 25, 2013) (V.C. Parsons)

In this case, two members of a joint venture formed as a Delaware LLC disputed the scope of a clause in the LLC agreement stating that interactive video and advertising activities in North America by either member or their affiliates must take place exclusively through the joint venture. The joint venture, Mobilactive Media LLC ("Mobilactive"), was formed by plaintiff Terry Bienstock ("Bienstock") and defendant Silverback Media, PLC ("Silverback). Other defendants included Adenyo, Inc. ("Adenyo"), which was the Canadian parent of Silverback, and two Delaware corporations that were subsidiary entities of Adenyo.

Bienstock alleged that Silverback and its affiliates breached the Mobilactive LLC Agreement, and usurped corporate opportunities belonging to Mobilactive by, among other things, acquiring competing businesses through subsidiaries without offering Mobilactive or Bienstock an opportunity to invest in these acquisitions. Silverback argued that these acquisitions did not violate the LLC agreement under Silverback's interpretation, but the court found that Silverback's interpretation was incorrect and that its conduct breached the LLC agreement.

The court next addressed Bienstock's claims that Silverback breached its fiduciary duties by usurping corporate opportunities rightfully belonging to Mobilactive. The LLC agreement provided that the parties were to act in the best interest of Mobilactive and exercise utmost good faith and fair dealing, and the court stated that under Delaware common law parties to a joint venture are required to act with the utmost good faith, fairness and honesty with each other with respect to the enterprise. The court found that

certain of the alleged opportunities were within Mobilactive's line of business and that Mobilactive had an interest or expectancy in those opportunities. Silverback alleged that Mobilactive did not have the financial ability to exploit the opportunities. The court disagreed, but also held that, based on corporate precedent, there is no need to consider the financial ability of Mobilactive to exploit the opportunities in a corporate opportunity analysis where there is a parallel contractual obligation to present corporate opportunities. The court also found that, as a result of the alleged usurpation, Silverback stood in a position inimicable to its duties to Mobilactive. The court thus found that the elements of the corporate opportunity test were satisfied with respect to certain opportunities taken by Silverback and held that Silverback breached its fiduciary duties.

After Bienstock initially sued Silverback, Adenyo acquired all of the assets of Silverback in consideration solely for a deed of indemnity by Adenyo to pay all claims of Silverback's creditors in Silverback's liquidation. Bienstock alleged that such transfer constituted a fraudulent transfer because the transfer was made by Adenyo with actual intent to hinder Bienstock's ability to enforce his rights under the LLC agreement. In addition to other defenses, Adenyo argued that the court had no personal jurisdiction over it. The court found that it had personal jurisdiction over Adenyo under Delaware's long-arm statute because Adenyo "purposely availed" itself of the benefits and protections of Delaware by incorporating Delaware subsidiaries for the purpose of acquiring the entities that formed the basis of the Silverback's wrongful usurpation of Mobilactive's corporate opportunities. The court also found that Adenyo was subject to personal jurisdiction under LLC Act Section 18-109 (the LLC Act's implied consent statute) because Adenyo participated materially in the management of Mobilactive by causing a petition seeking judicial dissolution of Mobilactive be filed in the court. The court then held that the transfer by Silverback to Adenyo constituted a fraudulent transfer.

The court next addressed the petition for judicial dissolution of Mobilactive that had been filed by Adenyo on behalf of Silverback. The court noted that under existing Delaware case law even if the standard under LLC Act Section 18-802 for judicial dissolution is met, the court may decide in the exercise of its equitable powers not to grant the petition. In this case, the court found that it may not be reasonably practicable to carry on Mobilactive's business, but the court refused to order judicial dissolution. The court found that the breaches of contract and fiduciary duties by Silverback contributed materially to Mobilactive's inability to fulfill its business purpose and stated that Silverback should not be permitted to use its inequitable conduct to extricate itself from the joint venture. The court also found that a judicial dissolution might hinder Bienstock from recovering the damages he is due.

3. *AM General Holdings LLC v. The Renco Grp., Inc.*, C.A. No. 7639-VCN (Del. Ch. Dec. 21, 2012) (V.C. Noble); *The Renco Grp., Inc. v. MacAndrews AMG Holdings LLC*, C.A. No. 7668-VCN (Del. Ch. Jan. 18, 2013) (V.C. Noble)

These two related cases involved an organizational structure that included two LLCs: Ilshar Capital LLC ("Ilshar") and AM General Holdings LLC ("Holdco"). Holdco was one of two members of Ilshar. The other member was ILR Capital LLC ("ILR"), which was Ilshar's managing member. Holdco's members, in turn, were MacAndrews AMG

Holdings LLC ("AMG"), which was Holdco's managing member, and The Renco Group, Inc. ("Renco"). Ilshar's LLC agreement required ILR to cause Ilshar to pay Holdco a preferred return distribution on January 31 of each year, beginning in 2013. Under Holdco's LLC agreement, Holdco was required to distribute that preferred return to AMG and Renco; provided, that AMG's right to receive its portion of the distribution was limited when the distribution would cause AMG's "Revalued Capital Account" to be less than 20% of the aggregate value of the Revalued Capital Accounts. In that circumstance, Renco could eventually elect to receive the portion of the distribution that AMG would have otherwise been entitled to receive. In October 2012, ILR disclosed to Holdco and AMG that, instead of abiding by the terms of the Ilshar Agreement and making the preferred return distribution to Holdco, ILR instead caused Ilshar to pay or credit directly to Renco the portion of the preferred return distribution to which Renco would have been entitled under the Holdco Agreement if Holdco had received preferred return distribution.

In the *AM General Holdings* case, Holdco moved for a preliminary injunction, alleging that ILR violated the express terms of the Ilshar Agreement by not making the preferred return distribution to Holdco as required under the Ilshar LLC Agreement. The court granted the preliminary injunction, finding that Holdco had established much more than a reasonable probability of success on its breach of contract claim and that ILR's breach deprived AMG of its contractual right as Holdco's managing member to assess the Revalued Capital Accounts and then disburse the preferred return distribution according to the Holdco LLC agreement.

In the *Renco Group* case, Renco asserted that AMG violated the Holdco LLC agreement by making an improper tax distribution solely to AMG. Renco requested an order for expedited discovery and scheduling of a hearing on its motion for preliminary injunction, which the court granted. The court found, among other things, that Renco pled a colorable claim regarding whether AMG had "reasonably determined" the balance of the Revalued Capital Accounts as required by the Holdco LLC agreement in connection with the distribution of funds, which could lead to improper transfers of funds and threaten Renco with irreparable harm. The court therefore granted Renco's motion.

4. *Gerber v. Enterprise Holdings, LLC, n/k/a Enterprise Products Holdings, LLC*, C.A. No. 3543-VCN (Del. Ch. Jan. 18, 2013) (V.C. Noble)

This case involved the purchase by Enterprise GP Holdings, L.P., a master limited partnership (the "Partnership"), of Texas Eastern Products Partners, LLC ("Teppco GP") from affiliates of Dan L. Duncan ("Duncan"), who indirectly owned the general partner (the "General Partner") of the Partnership and controlled the Partnership. In 2005, Duncan caused an affiliate of the General Partner to purchase Teppco GP. Twenty-seven months later, the Partnership purchased Teppco GP for the same purchase price but after certain assets worth almost half the transaction price were stripped and retained by Duncan (the "Transaction"). The Partnership later merged with another limited liability company ("MergeCo") and no longer exists. Defendants' motion to dismiss under Rule 12(b)(6) was granted because plaintiff failed to state a claim.

Plaintiff, a former limited partner of the Partnership and current holder of interests in the parent of MergeCo, challenged the Transaction on behalf of the Partnership as unfair to the Partnership, claiming the defendants breached fiduciary duties in approving the Transaction. The limited partnership agreement of the Partnership (the "LPA") eliminated common law fiduciary duties of the General Partner and its board of directors, as permitted by Section 17-1101(d) of DRULPA. Under the LPA, a conflict of interest between the General Partner and the Partnership would be permitted, deemed approved by all partners of the Partnership, and not constitute a breach of the LPA or any duty if the course of action was approved by "Special Approval" of a majority of members of the Partnership's Audit and Conflicts Committee (the "Committee"). The Committee was a committee of the Board of Directors of the General Partner composed of three or more directors meeting the independence, qualification and experience requirements established by the Securities Exchange Act and the rules and regulations of the Commission thereunder and by the New York Stock Exchange (the "NYSE").

Plaintiff claimed the Committee failed to meet the LPA's independence standards under the NYSE's rules and regulations and failed to act in good faith in considering the Transaction. The NYSE Listed Company Manual provided that a director qualifies as independent if the board "affirmatively determines that the director has no material relationship with the listed company" and none of the disqualifying conditions apply. The court found that the Partnership made the affirmative determination required and that none of the disqualifying conditions applied, and, therefore, the NYSE Listed Company Manual requirements were satisfied. It did not matter that members of the Committee owned units in limited partnerships controlled by Duncan because the NYSE Listed Company Manual explicitly provided that ownership of stock does not, by itself, bar an independence finding.

Plaintiff further contended that the Committee failed to act in good faith in considering the Transaction. The LPA eliminated common law fiduciary duties and contained a specific mechanism for resolving conflicts of interest—approval by a majority of the members of the Committee—which did not include an express duty to act in good faith. The court found that, even if a separate provision in the LPA requiring good faith applied, the Committee did not violate such duty. The LPA defined "good faith" as a belief "that the determination or other action is in the best interests of the Partnership." Courts have interpreted similar language to mean the actor subjectively believed the act was in the best interests of the limited partnership, requiring a complaint to allege defendants had a subjective belief that the act was not in the best interests of the limited partnership. The inquiry focuses on conduct evidencing an "intent to harm the company." The court held that a run-up in the price of Teppco GP over more than a 2-year period alone was not sufficient to trigger a reasonable inference that defendants lacked a subjective belief that the Transaction was in the Partnership's best interests, and the court would not "speculate or guess as to whether the price paid was appropriate under market conditions at the time." Because the Transaction was granted Special Approval, the defendants satisfied their express obligations under the LPA and plaintiff failed to state a claim.

The court also considered whether defendants breached the implied covenant of good faith and fair dealing, which a limited partnership agreement cannot contractually eliminate pursuant to Section 17-1101(d) of DRULPA. The court held that, because the LPA did not require consideration of any particular factors in granting Special Approval, exculpated defendants from liability absent bad faith, fraud, willful misconduct, or knowledge that conduct was criminal, and expressly waived fiduciary duties, a judicially-imposed requirement that Special Approval be objectively fair and reasonable could not be read into or reconciled with the LPA's framework. Plaintiff's claim against other defendants for aiding and abetting a breach of fiduciary duty similarly failed because plaintiff failed to state a claim for breach of fiduciary duty.

Defendants also challenged plaintiff's standing to bring the claims because plaintiff did not make a demand on the General Partner to bring the action. Although the court found that plaintiff's claims failed to state a claim and, therefore, should be dismissed, it also addressed defendants' claim that plaintiff lacked standing because he failed to make a pre-suit demand, noting that standing is a threshold question. The court looked to the corporate law test found in *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004), for determining whether a claim is direct or derivative, which asks (1) who suffered the alleged harm and (2) who would receive the benefit of the recovery or remedy. The court noted the difficulties of applying corporate law derivative rules to partnership-related claims, but nonetheless applied the established principles of the *Tooley* analysis. The court determined that all of plaintiff's claims were derivative. In a derivative action, Section 17-1003 of DRULPA requires a complaint set forth with particularity plaintiff's efforts to secure initiation of the action by the general partner or the reasons for not making such efforts. Plaintiff claimed that the Partnership paid too much for Teppco GP and thus, if successful, any recovery would be paid to the Partnership, or MergeCo as the Partnership's successor. Plaintiff claimed that the General Partner was controlled by Duncan's interests and therefore could not have independently and fairly assessed whether to pursue the action. Although the General Partner acts through its board of directors, because DRULPA refers to the general partner of the limited partnership and not to the general partner's governing body, the General Partner's independent board would not overcome Duncan's control over the General Partner for purposes of determining whether demand was futile. Therefore, the court held that demand was excused and plaintiff had standing to bring the action.

5. *Metropolitan Life Ins. Co. v. Tremont Grp. Holdings, Inc.*, C.A. No. 7092-VCP (Del. Ch. Dec. 20, 2012) (V.C. Parsons)

In this case, the Delaware Court of Chancery was presented with a motion to dismiss numerous claims by certain limited partners of Tremont Opportunity Fund II, L.P., a Delaware limited partnership (the "Fund"), against Tremont Partners, Inc., a Connecticut corporation and the general partner of the Fund (the "General Partner"), Tremont Group Holdings, Inc., a Delaware corporation and the parent of the General Partner (the "Parent"), and certain individuals that were officers, directors, managers and principal decision makers of the General Partner and the Parent (the "Individual Defendants"). The claims were all related to losses connected with an investment by the Fund in a hedge fund (the "Hedge Fund") that invested most of its assets in Bernard Madoff's ponzi

scheme. The General Partner was also the general partner of the Hedge Fund. In the context of this motion to dismiss, the court addressed, among other things, whether (i) the court had jurisdiction over the Individual Defendants, (ii) an exculpation provision in the partnership agreement of the Fund barred plaintiffs' claims, (iii) certain claims were derivative or direct and whether the derivative claims should be permitted notwithstanding a settlement in an action involving similar claims filed by other limited partners of the Fund in the United States District Court for the Southern District of New York (the "New York Case"), (iv) plaintiffs could maintain a valid breach of contract claim under the partnership agreement of the Fund and a private placement memorandum (the "PPM") relating to interests in the Fund on which plaintiffs' allegedly relied, (v) defendants' breached the implied covenant of good faith and fair dealing and (vi) whether the Parent could be liable for aiding and abetting the General Partner's alleged breach of fiduciary duty.

The court first addressed whether it could exercise personal jurisdiction over the Individual Defendants. The partnership agreement of the Fund included a clause pursuant to which the parties thereto consented to the exclusive jurisdiction of the Delaware courts. However, the court observed that the Individual Defendants were not parties to the partnership agreement of the Fund simply by virtue of being directors, officers, managers or decision makers of the General Partner and thus they were not bound by such provision. Plaintiffs' further claimed that the court had jurisdiction under Delaware's long-arm statute, but the court granted the Individual Defendants' motion to dismiss on this issue, finding that participation in the formation of the Fund and having management positions in the Fund did not cause the Individual Defendants to have contacts with the State of Delaware so extensive and continuing that exercising personal jurisdiction would be fair and consistent with state policy. The court also found that the alleged wrongs did not arise out of conduct that occurred within the State of Delaware, and therefore, the court did not have personal jurisdiction on that basis under the Delaware long-arm statute.

The court next turned to defendants' argument that an exculpation provision in the partnership agreement of the Fund barred plaintiffs' claims for breach of contract, breach of fiduciary duty, negligent misrepresentation and unjust enrichment. This provision essentially exculpated the General Partner and the Parent for any losses or expenses except those resulting from gross negligence, willful misfeasance, bad faith or reckless disregard of duties under the partnership agreement of the Fund. Plaintiffs claimed that they adequately pled facts that would support a finding of gross negligence. The court referred to the definition of "gross negligence" in the civil context as "a higher level of negligence representing an extreme departure from the ordinary standard of care." The court further indicated that gross negligence is a decision "so grossly off-the-mark as to amount to reckless indifference or a gross abuse of discretion." The court stated that, under the law of entities, gross negligence "involves a devil-may-care attitude or indifference to duty amounting to recklessness." In order to prevail on a claim of gross negligence, the court stated that a plaintiff must plead and prove that the defendant was "recklessly uninformed" or acted "outside the bounds of reason." Plaintiffs' generally claimed that defendants committed gross negligence by failing to supervise, monitor and manage investments by the Hedge Fund in the Madoff ponzi scheme and instead blindly

and recklessly handed over their responsibility to Madoff without performing any due diligence. The court observed that while no Delaware case has addressed whether failure to heed "warning signs" can constitute gross negligence in the partnership context, the analysis in *Forsythe v. ESC Fund Mgmt. Co. (U.S.)* was instructive. The court noted that in *Forsythe*, a motion to dismiss that accused the general partner of failing to oversee an affiliate that was delegated management responsibility for the subject limited partnership was denied. The court found that in this case, defendants' conduct was arguably more egregious than that at issue in *Forsythe*, and therefore, the court denied the motion to dismiss based on the exculpation provision.

The court next addressed whether plaintiffs' breach of fiduciary duty and unjust enrichment claims were derivative or direct claims. The court applied the test set forth in the corporate case of *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, which requires answering two questions in making this determination: (1) who suffered the alleged harm; and (2) who would receive the benefit of any recovery or other remedy. The court noted that these claims related to a diminution in the value of the Fund and the Hedge Fund resulting from the Madoff ponzi scheme. According to the court, these injuries were suffered by the Fund and the Hedge Fund, and only indirectly by plaintiffs, and thus, they were derivative in nature. With respect to these claims and all other derivative claims asserted by plaintiffs, including, among others, claims of negligent misrepresentation and intentional misrepresentation, plaintiffs argued that their claims must have been direct because they elected to opt-out of the settlement in the New York Case. The court found, however, that opting-out of a settlement cannot convert a derivative claim to a direct claim. The court further held that because the settlement released defendants with respect to derivative claims, the court was bound by res judicata and thus granted the motion to dismiss.

Plaintiffs alternatively argued that principles of equity warranted disregarding the distinction between their direct and derivative claims. Although the court acknowledged that there was some authority under the *Cencom* and the *Anglo American* limited partnership cases that principles of equity could warrant disregarding a distinction between direct and derivative claims, the court found that those cases involved unique circumstances and there were no similar circumstances in the present case that warranted disregarding the derivative nature of plaintiffs' claims.

The court then discussed defendants' motion to dismiss plaintiffs' claim that defendants breached the partnership agreement of the Fund and the PPM because they allegedly failed to analyze, evaluate and monitor the Madoff-related investments in any manner whatsoever and failed to perform any meaningful due diligence or to monitor the Hedge Fund's investments. The court looked to the PPM, which expressly provided that the General Partner would monitor the Fund's investments and evaluate information regarding the personnel, history and background of professional investment management firms in selecting managers of the Fund. The court also assessed the partnership agreement of the Fund, which provided that the General Partner and its affiliates were not obligated to do or perform any act or thing in connection with the business of the Fund not expressly set forth in the partnership agreement of the Fund. The court found that this provision conflicted with another provision in the partnership agreement of the Fund,

which provided that the PPM did not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements therein not misleading. In applying well settled Delaware principles of contract interpretation, the court found that because of this conflict, the partnership agreement of the Fund was ambiguous as to whether it incorporated the promises made in the PPM that were allegedly breached. Because any ambiguity must be resolved in favor of the nonmoving party, the court denied defendants' motion to dismiss the breach of contract claim.

With respect to plaintiffs' claim that defendants' breached the implied covenant of good faith and fair dealing, the court stated that plaintiffs' must have alleged (1) a specific obligation implied in the partnership agreement of the Fund, (2) a breach of that obligation, and (3) resulting damages. Plaintiffs alleged that the General Partner had an obligation to refrain from unreasonable conduct and had an implied contractual obligation to collect, analyze and evaluate information when selecting investment managers and to monitor their performance after any such selection. The court held that this allegation was conclusory and did not amount to pleading a specific implied contractual obligation as required to survive a motion to dismiss. Accordingly, the court granted defendants' motion to dismiss this claim.

Finally, the court addressed plaintiffs' claim that the Parent aided and abetted the General Partner's alleged breach of fiduciary duty. To make a valid aiding and abetting claim, the court indicated that plaintiffs must demonstrate: (1) the existence of a fiduciary relationship, (2) the fiduciary breached its duty, (3) a defendant, who is not a fiduciary, knowingly participated in a breach, and (4) that damages to plaintiffs resulted from the concerted action of the fiduciary and the nonfiduciary. The court noted that the General Partner undoubtedly owed fiduciary duties to the limited partners of the Fund. With respect to the third element, the court indicated that, under Delaware law, the knowledge of an agent acquired while acting within the scope of his or her authority is imputed to the principal. In this case, the court found that the General Partner could be considered the Parent's agent, and the General Partner's knowledge could be imputed to the Parent. Thus, the court found that the third element was satisfied. The court did not address the fourth element and denied defendants' motion to dismiss this claim.

6. *Henson v. Sousa*, C.A. No. 8057-VCG (Del Ch. Dec. 19, 2012) (V.C. Glasscock)

Henson, Sousa and Wilkinson each owned a 1/3 interest in a Delaware LLC. Henson, believing Sousa and Wilkinson were taking steps to cut him out of the LLC's business, sought a temporary restraining order to enjoin Sousa and Wilkinson from engaging in actions to dissolve the LLC, terminate the LLC's employees, disrupt its customer relationships and transfer the LLC's assets and business to entities owned by Sousa and Wilkinson.

The court began its analysis by recounting the requirements to issue a temporary restraining order: (1) the existence of a colorable claim, (2) that irreparable harm will be suffered if relief is not granted and (3) a balance of hardships favoring the requesting party. With respect to the existence of a colorable claim, the court found that Henson alleged facts sufficient to establish colorable claims for breach of the LLC's Operating

Agreement, which required unanimous member consent to dissolve the LLC, and breach of fiduciary duties by Sousa and Wilkinson. Turning to the irreparable harm prong, Henson first contended that irreparable harm would result from Sousa and Wilkinson terminating relationships with customers and employees of the LLC. The court rejected this contention for two reasons. First, the LLC's core business relied on the use of intellectual property licensed from a related entity that was in the process of being wound up as a result of a separate action brought by Henson in another jurisdiction. Thus, the LLC's operations were already effectively suspended pending completion of winding up of the entity holding the relevant intellectual property. Second, Henson had separately acknowledged that Sousa and Wilkinson did not intend to destroy the ongoing business relationships of the LLC but, rather, to transfer them to a separate entity of which Henson was not an owner. Henson also argued that Sousa and Wilkinson intended to engage in a fraudulent transfer of assets from the LLC to a separate entity owned by Sousa and Wilkinson and that, under the Delaware Uniform Fraudulent Transfer Act ("DUFTA"), a colorable claim of a fraudulent transfer automatically entitles the party making such claim to injunctive relief without a separate showing of irreparable harm. The court also rejected this argument, noting that the unambiguous language of DUFTA provides that injunctive relief to prevent a fraudulent transfer is subject to applicable principles of equity, and the court held that these principles of equity require a showing of irreparable harm. The court thus denied plaintiff's request for a temporary restraining order.

7. *Duff v. Innovative Discovery LLC*, C.A. No. 7599-VCP (Del. Ch. Dec. 7, 2012) (V.C. Parsons)

Plaintiffs, former members of the defendant limited liability company (the "Company"), brought various claims relating to identical redemption agreements (the "Redemption Agreements") by which each sold their interests back to the Company. Plaintiffs alleged the Redemption Agreements contained a warranty limiting plaintiffs' tax liability for the years 2011 and 2012, which was exceeded when the Company allocated taxable income to each plaintiff that exceeded the purported limit. Plaintiffs brought a breach of contract claim for breach of the warranty, requested an accounting, and requested a declaratory judgment with respect to plaintiffs' rights under the Redemption Agreements for the 2012 tax year. Plaintiffs also asserted that the Company breached license agreements (the "License Agreements") and consulting agreements (the "Consulting Agreements") entered into in by each of plaintiff and the Company in connection with the Redemption Agreements for failure to pay plaintiffs for their services under such agreements.

The court held that it had subject matter jurisdiction over plaintiffs' claims for breach of the Redemption Agreements pursuant to Section 18-111 of the LLC Act, which confers jurisdiction on the Court of Chancery to hear actions regarding the internal affairs of LLCs. The Redemption Agreements were specifically contemplated by the LLC Act under Section 18-702, which provides that an LLC "may acquire, by purchase, redemption or otherwise, any limited liability company interest . . . of a member . . . ." Because Section 18-111 confers on the Court of Chancery subject matter jurisdiction to hear actions to interpret, apply and enforce documents and agreements "contemplated by any provision" of the LLC Act, the court had jurisdiction to hear plaintiffs' claims under the Redemption Agreements. The court rejected the Company's argument that the court

had discretion in exercising jurisdiction over plaintiffs' claims. Although Section 18-111 provides for concurrent jurisdiction with other courts, once plaintiffs selected the Court of Chancery, the court had no discretion as to whether to hear the case. Furthermore, the court noted that the Redemption Agreements related to the duties and obligations of the Company vis-à-vis the plaintiff-members. The fact that plaintiffs' interests were redeemed was of no import because redemption agreements are technically agreements among current members of an LLC and the LLC regarding the repurchase of the members' interests. Moreover, the Redemption Agreements were negotiated while plaintiffs were still members of the Company. The court held that it had jurisdiction to hear the remaining claims under the clean-up doctrine because the claim for breach of the Redemption Agreements was closely intertwined with the claims for an accounting, declaratory judgment, and breach of the License Agreements and Consulting Agreements.

The Company moved to have plaintiffs' claims relating to the Redemption Agreements dismissed under Rule 12(b)(6) for failure to state a claim, arguing that the Redemption Agreements were unambiguous and by their terms did not limit plaintiffs' tax liability, but only the total dollars distributed to plaintiffs in 2011 and 2012. The court denied the Company's motion, holding that plaintiffs sufficiently alleged facts in the complaint to support a claim for a mutual mistake requiring reformation of the Redemption Agreements. Plaintiffs alleged that the parties had a mutual agreement regarding the limit on their tax liability—based on alleged conversations among the parties—that was not properly incorporated into the Redemption Agreements.

Finally, the court denied the Company's motion to dismiss for improper venue even though the License Agreements contained an exclusive forum selection provision selecting the courts of California. The Redemption Agreements, which contained a non-exclusive forum selection provision selecting the courts of Delaware, incorporated the License Agreements by reference. The claim for breach of the License Agreements arguably arose out of the Company's obligations under the Redemption Agreements, and a reasonable interpretation of the Redemption Agreements was that the Company consented to jurisdiction in the Delaware Court of Chancery. Delaware courts will only declare a forum selection clause strictly binding if the parties use express, clear language that all other courts are excluded. Because the forum selection clause in the Redemption Agreements and the License Agreements conflicted, the selection was not clear and the Company's motion to dismiss was denied.

8. *Feeley v. NHAOCG, LLC*, C.A. No. 7304-VCL (Del. Ch. Mar. 20, 2012) (V.C. Laster); C.A. No. 7304-VCL (Del. Ch. Oct. 12, 2012) (V.C. Laster); C.A. No. 7304-VCL (Del. Ch. Nov. 28, 2012) (V.C. Laster)

The Court of Chancery released three opinions in the *Feeley v. NHAOCG, LLC* matter. In the first two *Feeley* decisions, the court determined that: (1) it had jurisdiction over defendant NHA OCG, LLC ("NHA") based on LLC Act Sections 18-110(a) and 18-109(a), and (2) it would largely grant plaintiffs' motion for judgment on the pleadings based on defendants' failure to abide by the terms of the operating agreement of Oculus LLC (the "Oculus Operating Agreement").

The court found that plaintiff Feeley had entered into a business relationship with defendants A. Akel, G. Akel, Newman, Hughes, and NHA. The parties had formed two LLCs: Ak-Feel LLC ("Ak-Feel"), formed by Feeley and A. Akel, and Oculus LLC ("Oculus"), formed by Ak-Feel and NHA. Ak-Feel's Operating Agreement designated Feeley as its Managing Member; the Oculus Operating Agreement in turn designated Ak-Feel as its Managing Member. As Managing Members of the two entities, Feeley and Ak-Feel had full and exclusive authority to manage, control, administer and operate Ak-Feel and Oculus, respectively. Additionally, the Oculus Operating Agreement enumerated the only permissible ways to remove Ak-Feel as its Managing Member: unanimous member consent, termination of Feeley or Akel, or default without cure by Ak-Feel under the Oculus Operating Agreement. Feeley also entered into an employment agreement with Oculus to serve as its President and CEO.

When the business relationship between Feeley and defendants soured, defendant NHA attempted to give Feeley notice that his employment contract with Oculus would not be renewed but he would remain an Oculus officer. Later, NHA also attempted to remove Feeley as an Oculus officer. However, NHA was not Oculus's Managing Member—Ak-Feel was—and the Managing Member had exclusive authority to act on behalf of Oculus. NHA also gave notice to Ak-Feel that it was exercising its right to remove Ak-Feel as Oculus's Managing Member, replacing Ak-Feel with NHA.

Plaintiffs filed suit to determine the validity of NHA's removal of Ak-Feel as Oculus's Managing Member and Feeley as its President and CEO. Defendants moved to dismiss the complaint for lack of personal jurisdiction. Plaintiffs then moved for judgment on the pleadings.

In its first decision, the court held that Section 18-110(a) granted it *in rem* jurisdiction to determine who validly holds office as a manager of a Delaware LLC. Notice of the claims to each defendant was proper; therefore, the court found that it had constitutional authority to determine who the Managing Member of Oculus was: Ak-Feel or NHA. The court also found that, pursuant to Section 18-109(a), it could exercise personal jurisdiction over those serving as managers of an LLC for the purpose of adjudicating breach of duty claims. The court viewed NHA as a manager because NHA participated materially in Oculus's management not only by removing Ak-Feel as Managing Member, but also by purporting to remove Feeley as an employee, and later as an officer—an action that only the Managing Member of Oculus could take, pursuant to the Oculus Operating Agreement. Finally, the court stated that, since NHA was subject to personal jurisdiction under § 18-109(a), the court had jurisdiction over the other counts of the complaint, which arose out of a common nucleus of operative fact. The court deferred ruling on the individual defendants' lack of personal jurisdiction claims pending further discovery and briefing.

After determining the jurisdictional issues, the court, in its second decision, largely granted plaintiffs' motion for judgment on the pleadings and entered the following four judgments: (1) that letters sent by NHA purporting to replace AK-Feel as Oculus' Managing Member were invalid and void because the Oculus Operating Agreement stated the only grounds under which AK-Feel could be removed and none of those

grounds applied; (2) that the termination letter sent by NHA attempting to terminate Feeley as President and CEO of Oculus was invalid because it was not sent by the Managing Member, AK-Feel, as required by the Oculus Operating Agreement; (3) that the attempted termination of both Feeley's employment and his position as President and CEO of Oculus was unlawful and void because the termination was not affected by Oculus' Managing Member, AK-Feel; and (4) that defendants' representations to third parties stating that AK-Feel and Feeley had been removed were incorrect.

In the court's third decision, it analyzed the five counterclaims of Oculus's non-managing member, NHA, against Oculus's managing member, Ak-Feel and Ak-Feel's managing member, Feeley.

NHA's counterclaims were largely based on Ak-Feel and Feeley's allegedly failed attempts at managing Oculus. NHA contended that Feeley did not identify a sufficient number of real estate projects for Oculus, that the projects that he did bring to Oculus "ended in disaster due to Feeley's gross negligence" and that Feeley negotiated certain real estate deals for himself rather than presenting the deals to NHA.

Count I alleged, *inter alia*, that Ak-Feel breached the Oculus Operating Agreement by engaging in self-dealing because Ak-Feel usurped opportunities that belonged to Oculus. The court rejected this allegation because Ak-Feel had no contractual obligation under the Oculus Operating Agreement to present opportunities to Oculus. Count I also alleged that Ak-Feel breached the Oculus Operating Agreement by taking action that amounted to gross negligence and willful misconduct; because Ak-Feel answered this portion of Count I, the court did not address the allegation in defendants' motion to dismiss.

Count II alleged that Feeley aided and abetted Ak-Feel's breaches of the Oculus Operating Agreement as discussed in Count I. The court denied plaintiffs' motion to dismiss these allegations, holding that Count II pled "a *Gotham Partners* claim against Feeley for aiding and abetting a breach of contract (odd as that sounds) to the same extent that a claim was pled in Count I." The court based this decision on the fact that Feeley, as the managing member of Ak-Feel, ultimately made Ak-Feel's decisions and carried out those decisions; therefore, Feeley knowingly participated in the contractual breaches of duty alleged in Count I.

Count III alleged that Ak-Feel and Feeley breached default fiduciary duties. The court determined that Ak-Feel, as Oculus's managing member, owed default fiduciaries to Oculus and that the Oculus Operating Agreement did not limit or eliminate those default fiduciary duties; therefore, the court denied plaintiffs' motion to dismiss Count III as to Ak-Feel. The court discussed the Delaware Supreme Court's decision in *Gatz* (which stated that the Court of Chancery's determination that the manager of an LLC owed default fiduciary duties was "dictum without any precedential value"), stating that "[t]he high court did not rule on whether the managers of an LLC owe default fiduciary duties." The court in this case stated that the Court of Chancery cases holding that default fiduciary duties apply to LLC managers were "appropriately viewed as *stare decisis* by this Court" and that a plain reading of LLC Act Section 18-1101(c) and its drafting history supported the existence of default fiduciary duties because "otherwise there

would be nothing for the operating company agreement to expand, restrict, or eliminate." The court noted that the Supreme Court has the power to hold that no such default fiduciary duties exist, but that the Supreme Court had not yet made that determination. Then, the court looked to the Oculus Operating Agreement and found that it provided limited exculpation from monetary liability as permitted by Section 18-1101(e) but that it did not eliminate fiduciary duties under Section 18-1101(c). The court interpreted the language of the Oculus Operating Agreement, limiting liability for Oculus's members, as an assumption in the Oculus Operating Agreement that fiduciary duties existed and could give rise to liability unless the exculpation right was triggered.

The court also determined that Count III properly alleged claims that Ak-Feel breached its duty of care and that Feeley engaged in willful misconduct because Feeley allegedly negotiated deals for himself and, as the managing member of Ak-Feel, Feeley controlled Ak-Feel, meaning that he could not "mentally segregate his decision-making" so as to properly negotiate deals for himself while somehow not acting in his capacity as the managing member of Ak-Feel.

The court held that Count IV properly stated a claim for breach of the duty of care against Ak-Feel, but not against Feeley because, in Count IV, defendants named Feeley in his capacity as the party in control of Ak-Feel, which in turn was the managing member of Oculus, and not in his capacity as actual manager of Oculus.

Finally, in Count V, defendants sought a declaratory judgment stating that NHA had the unilateral right under the Oculus Operating Agreement to force Oculus to cease its business operations; the court granted plaintiffs' motion to dismiss Count V because the Oculus Operating Agreement did not give NHA such a right.

9. *Matthew v. Laudamiel*, C.A. No. 5957-VCN (Del. Ch. Feb. 21, 2012) and (Del. Ch. June 29, 2012) (V.C. Noble); *Matthew v. Fläkt Woods Grp. SA*, C.A. No. 5957-VCN (Del. Nov. 20, 2012) (*en banc*)

Plaintiff, a member and manager of Aeosphere LLC, a Delaware limited liability company (the "Company"), brought claims relating to the dissolution of the Company against the other managers of the Company and two companies with which the Company had business dealings. Defendants raised various defenses against plaintiff's claims and brought multiple counterclaims against plaintiff.

In the first decision by the Court of Chancery, the court addressed motions to dismiss for lack of personal jurisdiction by defendants Fläkt Woods Group SA ("Fläkt Woods") and SEMCO LLC ("SEMCO"), which were companies who had engaged in various business dealings with the Company. Plaintiff claimed that Fläkt Woods and SEMCO aided and abetted breaches of fiduciary duty by the other defendants and were otherwise complicit in the other defendants' wrongful actions. Plaintiff contended that the court had personal jurisdiction over Fläkt Woods under Delaware's long-arm statute by virtue of the conspiracy theory of jurisdiction. The court rejected plaintiff's conspiracy theory of jurisdiction because, although plaintiff pled sufficient facts to allow the court to infer that a conspiracy existed, plaintiff failed to show that Fläkt Woods knew or had reason to

know of an act or effect in Delaware before the completion of the conspiracy, which is a requirement of the conspiracy theory of jurisdiction.

Plaintiff asserted that the court had personal jurisdiction over SEMCO under Delaware's long-arm statute by virtue of the conspiracy theory of jurisdiction and/or by virtue of the general jurisdiction test. The court rejected the conspiracy theory, finding that sufficient facts were not alleged to support SEMCO's participation in a conspiracy against plaintiff, and rejected plaintiff's general jurisdiction argument, finding that SEMCO's minimal business in Delaware was not sufficient to constitute a "persistent course of conduct" or "regularly do[ing] or solicit[ing] business" in Delaware. Moreover, the court found that SEMCO's presence in Delaware was not sufficient to meet the "minimum contacts" required by constitutional due process.

The court also addressed plaintiff's motion to dismiss several of defendants' counterclaims. The court first addressed defendants' counterclaim for breach by plaintiff of the implied covenant of good faith and fair dealing in the Company's LLC agreement. One of defendants' claims for breach of the implied covenant was based on plaintiff's alleged refusal to accept or reject various contracts and alleged refusal to take certain actions requiring his approval under the LLC agreement. However the LLC agreement contained specific provisions dealing with "deadlocks" among the Company's board of managers and disagreements between the parties and contained a general standard governing the performance of managerial duties by the Company's managers and the officers. Other of defendants' claims for breach of the implied covenant were based on plaintiff's alleged unreasonable refusal to cooperate in the management of the Company and alleged improper allocation of Company resources among various internal projects. These claims again were squarely addressed by provisions in the LLC agreement. In addition, defendants' claimed that plaintiff's refusal to attend or otherwise participate in an emergency meeting of the board of managers meeting breached the implied covenant. Because the LLC agreement provided a "best efforts" standard to govern attendance at meetings of the board of managers, the court found this issue was also explicitly addressed by the LLC agreement. The court thus dismissed each of defendants' claims for breach of the implied covenant, holding that the implied covenant only operates where an LLC agreement does not speak to the issue directly and provide an explicit answer, and, in this case, each of defendants' bases for the implied covenant were directly addressed by the LLC agreement. The court stated the misconduct alleged by defendants was more properly addressed by defendants' counterclaims against plaintiff for breach of the LLC agreement.

In its initial decision, the court also addressed defendants' counterclaims for damages resulting from plaintiff's alleged breach of the employment agreement between the Company and plaintiff and for unjust enrichment, both of which claims were based upon plaintiff's alleged improper charging of personal expenses to the Company. The court held that these claims belonged to the Company and that defendants did not have standing to bring them in their individual capacities and thus dismissed these claims. Since a certificate of cancellation had already been filed to terminate the existence of the Company, the court stated that these claims would have to be brought in the name of the Company by a trustee or receiver appointed under LLC Act Section 18-805 or, if the

Company were revived, by the revived Company or derivatively by its members after the revival of the Company.

In a subsequent decision by the Court of Chancery, the court addressed plaintiff's motions for partial summary judgment on his claim that defendants breached the Company's LLC agreement by causing the dissolution and winding of the Company without plaintiff's consent and his claim that defendants' wrongful dissolution of the Company resulted in the unlawful conversion of his units in the Company. Plaintiff argued that his vote was required to approve the dissolution and winding up of the Company under Section 5.2.6(b) of the LLC agreement. The court held that that the plain language of Section 5.2.6(b) of the LLC agreement did not require plaintiff's vote to dissolve the Company but may have required plaintiff's vote to wind up the Company. Plaintiff argued that the apparent discrepancy in the LLC agreement between the vote required for dissolution and the vote required for winding up must be the result of a scrivener's error. The court rejected plaintiff's argument to reform the LLC agreement to correct the scrivener's error because plaintiff did not satisfy either of the standards for reformation, namely that there was a mutual mistake of the parties or a unilateral mistake by plaintiff of which defendants were aware but remained silent.

Plaintiff argued in the alternative that the voting provision in Section 5.6.2(a) of the LLC agreement required his vote for the dissolution of the Company, and therefore the vote to dissolve the Company without his approval breached the Company Agreement. Defendants' argued that, if such voting provision applied, plaintiff's refusal to attend the board meeting at which the vote was taken created a deadlock which would have allowed defendants to dissolve the Company without plaintiff's approval. The court denied plaintiff's motion for summary judgment on this issue, holding that the matter must be resolved on a more robust factual record.

With respect to plaintiff's claim that defendants' breached the LLC agreement by winding up of the Company without his approval, the court held that, unless defendants' prevailed on an affirmative defense, they would be liable for breach of the LLC agreement because the voting provision of the LLC agreement expressly required the unanimous approval of the board of managers to wind up the Company. The court rejected defendants' argument that "unanimous approval of the Board" meant unanimous approval of the managers present at a meeting, which interpretation would have resulted in actions requiring "unanimous approval of the Board" under the LLC agreement requiring a lesser vote than typical Board actions.

As an affirmative defense, defendants alleged that even if their approval of the decision to wind up the Company breached the LLC agreement, the breach was excused by plaintiff's prior material breaches of the LLC agreement, such as plaintiff's alleged refusal to approve or disapprove contracts requiring his approval and his alleged improper approval of contracts that also required another manager's approval. The court, noting that only a material breach, and not a nonmaterial or de minimis breach, will excuse another party from performing under a contract, stated that the issue of materiality is principally a question of fact and is not generally suited for disposition by summary judgment. The court held that defendants' allegations of plaintiff's breaches were not so

severe or so insignificant as to allow the court to assess their materiality on the facts presented and without further development of the record. Since these allegations raised contested issues of fact, the court was unable to grant plaintiff's motion for partial summary judgment on plaintiff's breach claim with respect to the winding up of the Company.

The court also denied plaintiff's motion for partial summary judgment on his conversion claim. Since plaintiff was not granted summary judgment on his breach claims, which were the foundation for his conversion claim, he similarly could not be granted summary judgment on his conversion claim.

In a further proceeding in this case, the Supreme Court of Delaware reversed the Court of Chancery's earlier decision that the court lacked personal jurisdiction over Fläkt Woods. The court found that Delaware's long arm statute reached the alleged conduct. The Court of Chancery had held that plaintiff failed to show that Fläkt Woods knew or had reason to know of an act or effect in Delaware before the completion of the conspiracy. The Supreme Court disagreed with the Court of Chancery's holding, finding, among other things, that Fläkt Woods, a sophisticated company with global activities, would have done some minimal due diligence before entering into a long-term agreement with the Company, which would have revealed to Fläkt Woods that the Company was a Delaware LLC long before the Company was dissolved. Because Fläkt Woods' alleged co-conspirators filed a certificate of cancellation for the Company in Delaware, which constituted the transaction of business in Delaware for purposes of the long-arm statute, the Supreme Court held that Fläkt Woods was subject to personal jurisdiction under the long arm statute.

10. *New Media Holding Co. L.L.C. v. Brown*, C.A. No. 7516-CS (Nov. 14, 2012) (C. Strine)

Plaintiff, which was a partner in Iota Ventures LLP, a Delaware limited liability partnership ("Iota LLP"), sued Grant Brown, who, in his capacity as an employee of a fiduciary services company based in the Channel Island of Jersey, had been hired to manage Iota LLP, and sued the fiduciary services company, alleging that Brown and the fiduciary services company had abused their management position and helped dilute plaintiff's interest in Iota LLP. Defendants moved to dismiss for lack of personal jurisdiction.

The court found that Delaware's long-arm statute did not confer personal jurisdiction on defendants because plaintiff's claims were not related to acts that defendants carried out in Delaware. The court stated that defendants' acts of creating Iota LLP and paying its annual partnership taxes in Delaware did not relate to the acts that formed the basis for plaintiff's claims. The court noted that DRUPA's implied consent statute (DRUPA Section 15-114) provides for service of process on the partners and liquidating trustees of partnerships, but not on others performing management functions for a Delaware partnership. The court thus granted defendants' motion to dismiss.

11. *Auriga Capital Corp. v. Gatz Prop., LLC,* C.A. 4390-CS (Del. Ch. Jan. 27, 2012) (C. Strine); *Gatz Prop., LLC v. Auriga Capital Corp.*, C.A. No. 4390-CS (Del. Nov. 7, 2012) (*en banc*)

Plaintiffs were minority members of Peconic Bay, LLC, a Delaware LLC (the "Company"), who brought this action against defendant Gatz Properties, LLC, the manager of the Company (the "Manager"). The Manager was managed and controlled by defendant William Gatz, an individual ("Gatz"). At all relevant times, Gatz and his family members owned a majority of the voting interests in the Company. The Company held a leasehold interest in golf course property that was owned by Gatz and his family members, which was subleased (the "Sublease") by the Company to a third-party golf course operator (the "Operator"). Plaintiffs alleged that the Manager breached its contractual duties under the LLC agreement of the Company and its fiduciary duties to the Company and its minority members by taking actions designed to oust the minority members so that the Manager and Gatz family members could use the assets of the Company to their own benefit. In its post-trial opinion, the Delaware Court of Chancery held in favor of the plaintiffs.

The Manager first argued that its actions were not subject to a fiduciary duty analysis because the LLC agreement of the Company displaced common law equitable principles. In finding that traditional fiduciary duties did apply in the context of an LLC, the court noted that Section 18-1104 of the LLC Act provides a statutory mandate that equitable principles apply to an LLC. The court also looked to Section 18-1101(c) of the LLC Act, which permits fiduciary duties to be modified or eliminated, and found that this statutory provision implies that fiduciary duties must have existed in the first place. The court then addressed whether a manager of an LLC qualified as a "fiduciary" and, citing to Delaware precedent, indicated that a "fiduciary relationship is a situation where one person reposes special trust in and reliance on the judgment of another or where a special duty exists on the part of one person to protect the interests of another." The court found that because a manager of an LLC has more than an arms-length, contractual relationship with the members of the LLC it manages and is vested with discretionary power to manage the business of the LLC, it is a fiduciary. Turning to the terms of the LLC agreement of the Company, the court noted that the LLC agreement of the Company did not contain any general provision stating that the only duties owed by the Manager were set forth in the LLC agreement. In relevant part, the LLC agreement provided that the Manager could not cause the Company to enter into an agreement with an affiliate that was less favorable to the Company than the terms of similar agreements that could be entered into with "arms-length third parties" without the consent of a majority of the non-affiliated members. The court referred to prior cases in noting that this arms-length language for self-dealing transactions implicated the fiduciary duty of loyalty and imposed the equivalent of the substantive aspects of "entire fairness" review, which is the "fair price" prong. However, the court indicated that the entire fairness procedural inquiry into "fair dealing" may also apply in some respects because the extent to which the process leading to alleged self-dealing deviates from the behavior one would expect in an arms-length deal is important to price determination. In this regard, where there was no real market test, and where the self-interested party's conduct may have

compromised the value of the asset in question, this could all bear on whether a fair price was paid.

With respect to the facts in this case, the court found that, as the plaintiffs alleged, the Manager knew in 2005 that the Operator intended to terminate the Sublease in 2010 pursuant to an early termination right that it had under the Sublease, but the Manager failed to take any action to address this expected loss, such as seeking a replacement operator for the golf course property. Instead, the court noted that the Manager sat back and waited for the Sublease to terminate and retained the cash surplus of the Company pursuant to a provision in the LLC agreement of the Company that permitted the Manager to retain funds that it reasonably determined were "necessary to meet the Company's present or future obligations," which in this case were future debt obligations of the Company after the Sublease terminated. The court found that the Manager took these actions because it desired to (i) let the Sublease terminate and to then use the property for residential properties, which it believed would be the best use and result in the highest value of the property and (ii) oust the minority members because it did not like having them interfere with what Gatz viewed as a Gatz family venture and that Gatz thought that if the Company were in a position of economic weakness, he could exploit that for the exclusive financial benefit of himself and his family. The court held that because the Manager was charged under the LLC agreement of the Company with the obligation to manage the operations of the Company, it had a fiduciary duty to manage the business loyally for the benefit of the members, which included the duty to address in good faith known, material risks that threatened the viability of the business of the Company. For these reasons, the court found that the Manager breached its fiduciary duties of loyalty and care by its bad faith and grossly negligent refusal to explore strategic options for the Company after knowing that the Operator would terminate the Sublease.

The court next turned to the Manager's dealings with a third-party that was interested in purchasing the Company or the lease owned by the Company. According to the court, the third-party asked to review the lease, the Sublease and other financial information, but the Manager refused to provide this information. Nevertheless, this offeror submitted an offer that unbeknownst to it, was below the Company's outstanding debt. However, rather than informing the offeror of this, the Manager put the offer to a membership vote knowing that it would be rejected and without informing the members that the offer was made without any due diligence by the offeror. The offeror then indicated that it was willing to negotiate an offer that could be north of $6 million, but the Manager never responded to this invitation to negotiate and the Manager never communicated this to the minority members. Although the Manager sought authorization from the minority members to approve a counteroffer of $6 million and the minority members approved it, the Manager, in its capacity as a member, and the Gatz family members, voted against it. The court held that the Manager violated its fiduciary duty of loyalty by its bad faith refusal to consider the third-party's offer to buy the Company or the lease owned by the Company and that it had also engaged in bad faith conduct when it presented to the minority members misleading information about the third-party's offer. Gatz submitted its own offer to purchase the Company for $6 million, which was rejected by the minority members, and then submitted a subsequent offer significantly lower than his initial offer

based on an appraisal he obtained without giving the appraiser all relevant information. Gatz indicated at trial that this was his attempt to play “hardball” with the minority members. The court found that playing “hardball” is how one would deal with competitors not teammates and that the Manager violated its fiduciary duty of loyalty in its own conduct in its buyout offers.

The Manager then put the Company up for sale by an auction, which the court considered a “sham.” The court noted that the Manager hired an auctioneer that had no experience with this type of transaction, that the auction was held within 90 days despite information available to the Manager from an appraiser that indicated that it would take six to nine months to market the property, that advertising commenced only two months prior to the auction date, with some of the advertisements being the size of postage stamps in newspapers of general circulation, that “as is” sale materials were offered to potential bidders that downplayed the value of the property, and that under the terms of the sale, the Manager was permitted to cancel the auction at any time before bidding began. Gatz was the only bidder at the auction and purchased the property for $50,000 in excess of the Company’s debt, which resulted in approximately $20,000 to the minority members. Based on these facts, the court held that no rational person acting in good faith could perceive the auction as adequate, and, thus, the Manager acted in bad faith and was grossly negligent in running the auction process. The court noted that the Manager sought to protect itself from liability by claiming that it relied on the auctioneer’s expert advice under Section 18-406 of the LLC Act, but held that a fiduciary cannot select an unqualified advisor instead of a qualified one and then claim he was guided by an expert, and, further, Gatz’s claim of “reliance” was undercut by his involvement in the development and approval of the marketing plan and the terms of sale.

The Manager also argued that based on their voting power as members, it and the Gatz family members could veto any option for the Company, so they could properly use a chokehold over the Company to pursue their own interests, and the minority would have to live with the consequences of their freedom of action. The court found that the Manager was indeed free to vote its membership interest however it desired in connection with a sale of the Company, but that it was not free to create a situation of distress by failing to cause the Company to explore its market alternatives and then to buy the Company for a nominal price. The court observed that the purpose of the duty of loyalty was to prevent the exploitation by a fiduciary of its position to the disadvantage of a minority.

Finally, the Manager argued that even if it breached its fiduciary duties, there was no economic harm because the Company was insolvent. The court found that Gatz is the one that put the Company in a position of relative economic weakness by not taking action and letting the Sublease lapse and then running a sham auction. The court, therefore, awarded the minority members their full capital contribution plus $72,500, the equivalent of a sale of the company at $6.5 million, which factored in the $6 million offer plus the cash the Company had on hand. The court also awarded one-half of plaintiff’s attorneys’ fees and costs based on Gatz’s conduct before and during the litigation and the breaches of the duty of loyalty.

Subsequent to the Court of Chancery's decision, Gatz filed an appeal, and Gatz Properties filed a voluntary Chapter 11 petition. When the Bankruptcy Court granted a motion for relief from the automatic stay, the Delaware Supreme Court was able to proceed with Gatz's appeal. Specifically, the Supreme Court held that Gatz did violate his contracted-for fiduciary duty to abide by the equitable standard of entire fairness in a conflict of interest transaction between himself and the Company by refusing to negotiate with a third-party bidder and by causing the Company to be sold to himself at an auction engineered by himself and sold to himself at an unfair price. The Supreme Court affirmed the Court of Chancery's award of damages and attorneys' fees.

The Supreme Court first analyzed whether the Court of Chancery correctly determined that Gatz owed contractually-agreed-to fiduciary duties to the other members of the Company. The Supreme Court held that Section 15 of the LLC Agreement, which prohibited related-party transactions that were "on terms and conditions which are less favorable to the Company than the terms and conditions of similar agreements which could then be entered into with arms-length third parties, without the consent of a majority of the non-affiliated Members[,]" was "the contractual equivalent of the entire fairness equitable standard of conduct and judicial review." The Supreme Court found that Section 15 of the LLC Agreement contractually adopted the fiduciary duty standard of entire fairness and the fair price obligation inherent in that standard. Thus, entire fairness (fair dealing and fair price) was the controlling fiduciary duty standard and, because no majority-of-the-minority vote occurred to approve the transaction as required by Section 15, Gatz had the burden to establish the transaction's fairness. The Supreme Court found adequate facts in the record to support the Court of Chancery's determination that Gatz did not establish the transaction's fairness and breached the fiduciary duty he owed to the minority members of the Company to engage in fair dealing and to obtain a fair price. Specifically, the record showed that the Company was worth more than Gatz paid, Gatz refused to properly deal with an interested third-party bidder, and the auction process was a "sham" based on the unprofessionalism of the marketing effort and the decision to auction off the Company as a distressed property as opposed to selling the Company in an orderly way. Therefore, the Supreme Court held that Court of Chancery properly determined that Gatz did not carry his burden of proving that he abided by his contracted-for fiduciary duty of entire fairness.

Second, the Supreme Court looked to whether the LLC Agreement exculpated Gatz. Section 16 of the Agreement permitted exculpation and indemnification of the Company's manager in certain instances. However, the Supreme Court found ample evidence in the record to support the Court of Chancery's determination that Gatz "acted in bad faith and made willful misrepresentations in the course of breaching his contracted-for fiduciary duty." Specifically, the court noted that Gatz knew that the Sublease likely would be terminated early, did not engage in any serious effort to look for a replacement golf course operator, refused to provide due diligence to a credible buyer, and decided to pursue a distressed sale auction when the Company's cash reserves would have permitted it to continue to pay its bills for three years while searching for a buyer. Because Gatz engaged in acts of bad faith and willful misconduct, the LLC Agreement offered him no exculpation.

Third, the Supreme Court considered the Court of Chancery's analysis regarding whether the Delaware LLC Act imposed default fiduciary duties. The Supreme Court found that the LLC Agreement explicitly and specifically addressed the "fiduciary duty issue" which controlled the dispute and that no litigant had asked the court to determine whether default fiduciary duties existed as a matter of statutory law. The Supreme Court also stated that the issue of whether the Delaware Limited Liability Company Act "does—or does not—impose default fiduciary duties is one about which reasonable minds could differ." Therefore, the Supreme Court held that the Court of Chancery's pronouncements about default statutory duties under the LLC Act "must be regarded as dictum without any precedential value."

Finally, the Supreme Court upheld the award of equitable damages because the record supported the Supreme Court's finding that Gatz breached a contracted-for fiduciary duty arising from equity and the award "was based on conscience and reason." Furthermore, the Supreme Court held that the award of attorneys' fees was warranted given the Court of Chancery's supported findings that Gatz engaged in bad faith litigation conduct.

12. *Hite Hedge LP v. El Paso Corp.*, C.A. No. 7117-VCG (Oct. 9, 2012) (V.C. Glasscock).

Plaintiffs, common unitholders of El Paso Pipeline Partners, L.P., a master limited partnership (the "Partnership"), brought a class action and derivative suit against the Partnership's controlling unitholder, El Paso Corporation ("El Paso"), alleging that El Paso breached its fiduciary duty by agreeing to a merger that allegedly led to a decline in market price of the units in the Partnership.

The asset base of the Partnership was derived from "drop down" transactions whereby the Partnership would acquire, often at a favorable price, pipeline and other energy assets from El Paso. However, El Paso merged with and into Kinder Morgan, Inc. ("KMI"), with KMI as the surviving entity. KMI had its own master limited partnership and following the merger, KMI engaged in "drop down" transactions with its master limited partnership to the exclusion of the Partnership. As a result, the market price of Partnership units declined by more than 15%. Plaintiffs alleged that El Paso, as controlling unitholder, had a duty to represent minority unitholders' interests in merger negotiations and that, by agreeing to the merger, El Paso extracted value from the Partnership at the expense of minority unitholders. El Paso moved to dismiss and the court granted El Paso's motion on the following grounds: (1) the partnership agreement of the Partnership validly and expressly eliminated any fiduciary duties that the controlling unitholder owed to minority unitholders; (2) the controlling unitholder did not use its control over the Partnership to harm minority unitholders because the merger did not involve the Partnership and the partnership agreement of the Partnership permitted El Paso to compete with the Partnership and disclaimed any liability of El Paso arising under the corporate opportunity doctrine; and (3) the controlling unitholder had not extracted value from the Partnership at the expense of the minority unitholders because nothing in the partnership agreement of the Partnership granted the minority unitholders the right to continued drop-down transactions.

13. *Seibold v. Camulos Partners LP*, C.A. No. 5176-CS (Del. Ch. Sept. 17, 2012) (C. Strine)

In this action, the plaintiff sought the return of capital he had invested in a hedge fund, Camulos Partners LP (the "Fund"), in connection with his withdrawal as a limited partner of the Fund. In addition to being an investor in the Fund, the plaintiff was also a founding partner of the Fund, a member of Camulos Partners GP LLC, the general partner of the Fund (the "General Partner"), and a partner and employee of Camulos Capital LP, the investment manager of the Fund (the "Investment Manager" and together with the Fund and the General Partner, "Camulos"). Dissatisfied with his career prospects at the Fund, the plaintiff sought to terminate his employment in order to start a competing fund, eventually named Noroton Event Driven Opportunity Fund LP ("Noroton"). In the months preceding his departure, the plaintiff downloaded a large number of Camulos files that he thought would be helpful in establishing Noroton.

After his resignation from the various positions he held at Camulos, the plaintiff requested the return of his $3.2 million capital investment in the Fund as well as the $1.45 million it had gained in value. Around this time, Camulos learned of the plaintiff's downloading activities. Believing that the plaintiff had breached various agreements, including the Fund's limited partnership agreement and a confidentiality agreement entered into by the plaintiff as an employee of the Investment Manager, the Investment Manager deposited the plaintiff's withdrawal proceeds into its own operating account to offset any claims against the plaintiff.

The plaintiff filed suit to recover the withdrawal proceeds, alleging breach of the Fund's partnership agreement by the Fund and the General Partner and tortious interference with contract and unjust enrichment with respect to the Investment Manager. Camulos counterclaimed, alleging, among other things, breach of fiduciary duty arising out of the plaintiff's non-return, improper use and disclosure of the downloaded information.

In response to the plaintiff's claim that Camulos breached the Fund's partnership agreement by failing to turn over his withdrawal proceeds, Camulos claimed that the proceeds were properly withheld pursuant to a provision of the partnership agreement permitting suspension of withdrawals under "extraordinary circumstances." The court disagreed with Camulos that the plaintiff's departure constituted an "extraordinary circumstance." Rather, the court concluded that the withdrawal suspension provision must be read in the context of the entire partnership agreement. Specifically, the partnership agreement required that "extraordinary circumstances" be related to the Fund in a way that would warrant suspending withdrawals, such as circumstances where it was impossible to fairly value the Fund's assets due to extreme market conditions.

The court also rejected Camulos' contention that a provision of the partnership agreement permitting the General Partner to act in its sole discretion displaced the "extraordinary circumstances" standard. In the court's view, the "extraordinary circumstances" standard was an exception to the general partner's ability to act in its sole discretion. Otherwise, according to the court, the "extraordinary circumstances" standard would be rendered superfluous. Camulos also argued that the Investment Manager was not liable for tortious interference because it was acting pursuant to authority delegated to it by the

General Partner under the investment management agreement. The court rejected this claim, noting that General Partner had delegated to the Investment Manager only the authority to oversee the day-to-day trading activities of the Fund.

With respect to Camulos' counterclaim for breach of fiduciary duty, the court first noted that the fiduciary duties the plaintiff owed in his capacity as a Camulos partner and employee were essentially co-extensive. Calumos first claimed that the plaintiff misused the information he downloaded but the court declined to address this claim because it concerned facts identical to those raised by Camulos' claim that the plaintiff had breached his confidentiality agreement. Camulos next claimed that the plaintiff solicited its customers while still an employee of Camulos but the court found no evidence supporting this claim. Camulos' final breach of fiduciary duty claim alleged that the plaintiff prepared to compete while still a Camulos employee. The court agreed that the plaintiff breached his duty by downloading Camulos files for his own use but concluded that Camulos had not demonstrated any harm resulting from the breach.

14. *In re Encore Energy Partners LP Unitholder Litig.*, C.A. No. 6347-VCP (Del. Ch. Aug. 31, 2012) (V.C. Parsons)

This case involved a class action by former unitholders of Encore Energy Partners LP (the "Partnership") who challenged the use of a "Special Approval" process that was employed by the general partner of the Partnership to approve a conflict transaction pursuant to which Vanguard Natural Resources, LLC ("Vanguard") acquired all of the outstanding common units of the Partnership in a unit-for-unit exchange (the "Merger"), where Vanguard's indirect subsidiary was the Partnership's general partner. Plaintiffs argued that the general partner of the Partnership, its board of directors and Vanguard breached their duties under the partnership agreement by proposing, approving and consummating the Merger. The defendants moved to dismiss.

In its analysis, the court first addressed what duties were owed by the defendants. The court referred to the partnership agreement of the Partnership, which essentially provided that none of the defendants had any duties or liabilities, including fiduciary duties, to the Partnership or any limited partner except as expressly set forth in the partnership agreement. The partnership agreement expressly provided that any actions taken by the general partner or any of its affiliates shall be made in "good faith." Thus, the court found that the defendants owed a contractual duty of good faith. However, the court also noted a specific mechanism in the partnership agreement for resolution of conflict transactions, which provided in relevant part that in the event there was a potential conflict of interest, any course of action by the general partner or its affiliates would be permitted and deemed approved by all partners, and would not constitute a breach of the partnership agreement or of any duty stated or implied by law or equity, if the course of action in respect of such conflict of interest was approved by "Special Approval." "Special Approval" was defined in the partnership agreement as "approval by a majority of the members of the Conflicts Committee acting in good faith." In turn, "good faith" was defined to require that the person taking the action "believe that the determination or other action is in the best interests of the Partnership." Based on prior cases, the court interpreted this language as requiring plaintiffs to allege facts from which one could

reasonably infer that the defendants subjectively believed that they were acting against the Partnership's interests. The court held that because the alleged wrongdoing related to the conflicted transaction—the Merger—and the partnership agreement provided a mechanism for approving a conflicted transaction, a determination that the Merger received valid Special Approval would compel a finding that no defendant breached the partnership agreement. Thus, the relevant question was whether the conflicts committed approved the Merger acting in subjective good faith.

The complaint alleged facts essentially in support of an argument that the conflicts committee was an ineffectual negotiator and did not get a good price for the units in the Partnership. Although the court acknowledged that the complaint alleged that the conflicts committee ran a "shoddy negotiation process," the court found that it did not allege sufficient facts from which one could reasonably infer that the conflicts committee subjectively believed they were acting contrary to the Partnership's interests by approving the Merger. In its finding, the court highlighted that the conflicts committee retained and relied on the advice of independent legal counsel and a competent financial advisor before approving the final merger agreement. On these basis, the court found that the approval by the conflicts committee of the Merger satisfied the definition of "good faith," thus immunizing the defendants' actions from challenge under the terms of the partnership agreement.

The court next turned to plaintiffs' claim that the defendants violated the implied covenant and that plaintiffs' allegations of ineffective bargaining demonstrated that the conflicts committee did not exercise its discretion in good faith in conducting negotiations with Vanguard. The court noted that although the plaintiffs were correct that the defendants' discretionary use of Special Approval implicated the implied covenant, the plaintiffs incorrectly suggested that the implied covenant required a duty of objective fairness or effectiveness. The court indicated that, to have a successful claim, the plaintiffs would have to demonstrate that the allegedly "feckless" negotiations frustrated the fruits of the bargain that the parties reasonably expected. The court held that it could not infer from the terms of the partnership agreement that the use of Special Approval would be conditioned on achieving an objectively "fair and reasonable" value for plaintiffs' units.

The court also found an alternative and independent reason why the plaintiffs did not state a valid claim under the implied covenant. The court noted that the implied covenant would only apply to the general partner of the Partnership, which was the party to the agreement, and the general partner was given an express right under the partnership agreement to rely on the opinions of investment bankers. The court held that it could reasonably be inferred that the general partner relied on the fairness opinion provided by the investment bankers engaged by the conflict committee.

15. *Policemen's Annuity & Benefit Fund of Chicago v. DV Realty Advisors LLC*, C.A. No. 7204-VCN (Del. Ch. Aug. 16, 2012) (V.C. Noble)

In this post-trial opinion, the court granted the limited partners' (the "LPs") request for a declaration that they validly removed a general partner of a Delaware limited partnership

(the "Partnership"). The general partner of the Partnership argued that the LPs did not meet the express and implied requirements for removal "without cause" under the partnership agreement of the Partnership. The express requirement as set forth in the partnership agreement required that consenting LPs "in good faith determine that removal of the general partner was necessary for the best interests of the Partnership." The general partner argued that, under the *Wilmington Leasing* and *Desert Equities* cases, this included an implied requirement that the decision of the LPs be "objectively reasonable" under the implied covenant of good faith and fair dealing. The LPs countered that the implied covenant did not apply.

The court first noted that under the general rule for declaratory judgments, the LPs had the burden of proof and this case did not warrant an exception. The court then differentiated *Wilmington Leasing* and *Desert Equities* from the present case by finding that unlike the provisions at issue in those cases, the applicable provision in the partnership agreement of the Partnership as set forth above expressly provided how discretion was to be exercised, and thus, there was no room for the implied covenant. The court next addressed whether the LPs made a determination in good faith that removal was in the best interest of the Partnership. The court observed that the partnership agreement did not define "good faith" and that "good faith" sometimes includes objective as well as subjective elements. The court found that the use of "good faith" in the partnership agreement was ambiguous, noting that the parties to the partnership agreement could have expressly provided for "subjective" good faith or "reasonableness." However, because the partnership agreement by its terms was governed by Delaware law, the court looked to the common law definition in the fiduciary context, finding that it was historically subjective, but that there is some conduct which is so unreasonable that the court will necessarily determine that it could not have been done in good faith. The court cited to a case in a footnote that found that "objective factors could be used as a proxy for determining subjective intent." The court also looked to the UCC's definition of "good faith" for guidance, although it acknowledged that the UCC would not apply in this case, which defines good faith as "honesty in fact and the observance of reasonable commercial standards of fair dealing." In collectively applying these standards of good faith to the facts present in this case, the court found that the LPs acted in good faith in determining to remove the general partner of the Partnership. In so doing, the court pointed to reports that the LPs received from third party consultants recommending removal of the general partner, evidence demonstrating that the general partner failed to timely provide financial statements as required by the partnership agreement, the resignation of certain individuals from an advisory committee to the Partnership and other "red flags."

16. *MICH II Holdings LLC v. Schron*, C.A. No. 6840-VCP (June 29, 2012) (V.C. Parsons); *MICH II Holdings LLC v. Schron*, C.A. No. 6840-VCP (Aug. 7, 2012) (V.C. Parsons)

Plaintiffs, who were members of two Delaware LLCs, brought this action for breach of fiduciary duty and breach of the LLCs' operating agreements against the LLCs' manager. In this decision, the court addressed a motion to stay or dismiss this action in favor of an earlier-filed lawsuit in New York, which the manager brought against the owners of plaintiffs and certain related entities. The court first addressed a forum selection clause

in the LLCs' operating agreements, which required that claims against the two LLCs be brought exclusively in Delaware. However, since this action was against the manager of the LLCs, not the LLCs, the court held that the forum selection clause did not apply. The court then analyzed whether to stay the proceedings under the *McWane* doctrine and granted defendant's motion to stay, finding that the New York action was filed first, the New York litigation and Delaware actions had substantially similar parties and issues, and the New York courts were capable of rendering prompt and potentially complete justice.

In a subsequent decision in this action, the court considered plaintiffs' motion for reargument on five separate grounds. The court denied all of plaintiffs' grounds for reargument except for plaintiffs' request to allow a claim that the manager has improperly withheld distributions allegedly owed to plaintiffs to proceed in Delaware in parallel with the New York litigation. The court stated that a challenge to the self-help actions taken by the manager of two Delaware LLCs to the detriment of holders of minority interests in those LLCs raises potentially important issues that should be addressed in a timely manner. The court granted plaintiffs' motion for reconsideration of this claim based on its determination that this claim was sufficiently discrete and separable from the issues presented in the New York litigation, which minimized the risk of wasteful, overlapping proceedings and conflicting judgments with the New York litigation.

17. *Picard v. Wood*, C.A. No. 6526-VCG (Del. Ch. July 12, 2012) (V.C. Glasscock)

In this case, defendant, a limited partner of a Delaware limited partnership, sought to have a claim against him dismissed for lack of personal jurisdiction. The court granted defendant's motion to dismiss, holding that it is well settled under Delaware law that mere membership in a Delaware limited partnership is insufficient to confer personal jurisdiction absent additional considerations. The court stated that because there were no allegations or evidence that defendant managed, controlled, or exerted influence over the limited partnership, it would be improper to exercise personal jurisdiction over him. In addition, plaintiff asserted that defendant's alleged service as a trustee of a Delaware charitable organization made him subject to personal jurisdiction. The court rejected this assertion because plaintiff's claims against defendant did not arise from defendant's alleged trustee service.

18. *ASB Allegiance Real Estate Fund v. Scion Breckenridge Managing Member, LLC*, C.A. No. 5843-VCL (Del. Ch. May 16, 2012) (V.C. Laster); C.A. No. 5843-VCL (Del. Ch. July 9, 2012) (V.C. Laster)

Plaintiffs, which are pension funds advised by ASB Capital Management, LLC ("ASB"), entered into five joint ventures for the ownership, operation and development of student housing with defendants, special purpose entities wholly owned by The Scion Group, LLC ("Scion"). Plaintiffs provided at least 99% of the capital for each joint venture and defendants were the sponsor and invested no more than 1%. After an initial joint venture containing a standard capital-event waterfall provision with a promote provision, the

parties agreed to a two tier promote going forward, which was memorialized in an email (the "Email") and agreed to by both parties.

The first joint venture agreement that contained the two tier promote provision placed the first promote after the first preferred return but before the return of capital, meaning defendants would begin to earn the promote before plaintiffs and defendants received back their capital. The parties executed several more joint venture agreements based on this form. When the mistake was discovered, plaintiffs sought to reform all of the agreements to conform to the two tier promote provision to what was agreed to in the Email. The Court of Chancery reformed the agreements under the doctrine of unilateral mistake, which allows for reformation when the party asserting the doctrine shows that it was mistaken "and that the other party knew of the mistake but remained silent" quoting *Cerberus Int'l Ltd. v. Apollo Mgmt., L.P.*, 794 A.2d 1141, 1151 (Del. 2002)). To prevail on a claim for reformation, the party must prove "by clear and convincing evidence that the parties came to a specific prior understanding that differed materially from the written agreement." *Id.* at 1151–52. The prior understanding tells the court exactly what the terms of the contract should be.

The court held that the prior Email constituted a "specific prior contractual understanding that provided the necessary foundation for reformation."

The court held that a "promote" is a term of art and contemplates the return of invested capital in the context of a capital event. Defendants' expert admitted that he had never heard of a real estate deal in which the promote was paid before the return of capital in a capital-event waterfall provision. The parties' understanding of the meaning of a "promote" was reflected in the two most heavily negotiated agreements—the initial agreement and a later agreement in which the parties attempted to mimic the two tier promote provision but did not use the prior forms, in that case drafting the return of capital to precede the first promote. Plaintiffs were unaware of the mistake in the agreements, and Eric, Scion's Executive Vice President and General Counsel admitted that he noticed the unusual placement of the first promote as well as the favorable implications for defendants, but remained silent. The court, noting that the basic principle of agency law—"knowledge of an agent acquired while acting within the scope of his or her authority is imputed to the principal"—applies to limited liability companies, imputed Eric's knowing silence to Scion.

The court rejected defendant's defense that a senior individual at ASB failed to read the agreements, noting that, unlike with avoidance, reformation is not precluded by a party's failure to read the writing at issue. Because reformation requires a prior agreement that reflects the actual agreement by the parties but which was not properly memorialized in the writing, reformation does not turn on whether the agreement was read. Defendants' ratification defense also failed because in the context of reformation, imputed or constructive knowledge is not sufficient; rather to ratify a contract subject to reformation there must be actual knowledge of the error. Because the plaintiffs did not know of the error and believed the agreements accurately reflected the two tier promote that was previously agreed upon, plaintiffs did not have actual knowledge of the error and did not ratify the agreements.

In a subsequent decision, the court addressed the fee-shifting provisions contained in the LLC agreements at issue in the prior decision. The LLC agreements contained fee-shifting provisions which entitled ASB, as the prevailing party, to fees and costs. The fee-shifting provisions provided that in any action by a party to the agreement to enforce the provisions of the agreement, the non-prevailing party must reimburse the prevailing party for all reasonable fees and costs, including reasonable attorneys' fees.

When interpreting fee-shifting provisions, the court focuses on enforcing the agreement and making the prevailing party whole. Unless the agreement provides for partial or claim-by-claim awarding of fees, the fees are usually applied "in an all-or-nothing manner."

The court held that defendants' counterclaims for breach of fiduciary duties and violation of the implied covenant of good faith and fair dealing were contract claims brought to enforce one of the LLC agreements and therefore were subject to the fee-shifting provision. The fiduciary duty claims were brought pursuant to a specific provision in the LLC agreement regarding fiduciary duties. The court held that the implied covenant claim was also a contract claim because it was based on the terms the parties would have agreed to had they thought to negotiate the issue. The court emphasized the temporal focus of the implied covenant claim—what the parties would have done *at the time of negotiating* rather than what the parties would have done at the time of the wrong, as would be the case for a tort claim.

The court also considered Delaware case law where the implied covenant turned on a culpable mental state such as that required for a claim of fraud, which suggests that the claim is not contractual. Typically a party would not contractually agree to the other party committing fraud. Therefore, the court held that this aspect of fraud in prior cases does not mean that a claim for breach of the implied covenant requires fraud, but rather that fraud is a way of establishing a breach of the implied covenant because "no fraud" is an implied contractual term. Because all of the claims at issue related to the LLC agreement, the court held that the fees and costs incurred by plaintiff, as the prevailing party, qualified for reimbursement under the fee-shifting provision.

19. *RPRS Gaming, L.P. v. HP Gaming Partners L.P.*, C.A. No. 6359-VCP (Del. Ch. June 13, 2012) (V.C. Parsons)

This case involved a proposed expansion (the "Proposed Expansion") of a casino in Philadelphia owned by a Delaware limited partnership. In this declaratory judgment action, plaintiff, a limited partner, sought a declaration, among other things, that the Proposed Expansion required supermajority approval of the management committee of the partnership, which would provide plaintiff with a blocking vote. Under the partnership's limited partnership agreement (the "LPA"), the Proposed Expansion, which would result in total project costs of $537 million, would require supermajority approval if the cost of the Proposed Expansion fell outside the approved range of 85% to 133% of "Budgeted Development Costs." The crux of the dispute among the parties was the correct measure of Budgeted Development Costs under the LPA.

Defendants, who consisted of the general partner and the only other limited partner of the partnership, moved for partial summary judgment and raised four arguments in support of their motion. First, defendants argued that Budgeted Development Costs were either $472.5 million, which is the estimated cost of the project included in a documents agreed among the parties in 2005, or $474 million, which was contemplated by a 2009 plan modifying the original casino construction plan in the aftermath of the 2008 financial crisis. Plaintiff asserted that Budgeted Development Costs were set at $742 million in 2008 pursuant to an amendment to the LPA. The LPA required the general partner to estimate Budgeted Development Costs after the award of a license by the Pennsylvania Gaming Control Board (the "PGCB"). Since the PGCB did not award a license to the partnership until 2008, the court rejected defendants' contention that the Budgeted Development Costs were established in 2005. The court concluded, however, that there were genuine issues of material fact with respect to whether $474 million or $742 million was the correct measure of Budgeted Development Costs and therefore denied defendants' summary judgment motion on this issue.

Defendants also argued that, notwithstanding the amount of the Budgeted Development Costs, the Proposed Expansion fell under an exception to the requirement for management committee supermajority approval for project modifications with respect to which "no material decrease to the scope of the [casino] will result." The court, noting that both "material" and "scope" were not defined terms in the LPA, held that it could not determine, as a matter of law, whether the Proposed Expansion materially decreased the scope of the casino.

Next, defendants raised the defense of equitable estoppel, which requires that defendants prove they reasonably relied on the conduct of plaintiff and suffered a prejudicial change of position as a result of their reliance. Defendants contended that plaintiff's prior approval of a different expansion plan for the casino equitably estopped plaintiff from blocking the Proposed Expansion. The court rejected this argument, noting that the partnership was free to complete the construction of the expansion in accordance with the plan approved by plaintiff and finding that defendants failed to prove either reasonable reliance or a prejudicial change of position.

Finally, defendants argued that plaintiff could not block the Proposed Expansion because to do so would be unreasonable and would thus violate a provision of the LPA providing that no approval or consent to a management committee decision be unreasonably withheld or delayed. Defendants averred that plaintiff would use its blocking vote to coerce defendants to modify the economics of the partnership in favor of plaintiff, which defendants contended would constitute an unreasonable withholding of plaintiff's consent. As with the defendants' first and second arguments, the court concluded it could not decide at this stage whether, as a matter of law, plaintiff's actions were unreasonable.

20. *RWI Acquisition LLC v. Ronny Dee Todd*, Civil Action No. 6902-VCP (Del. Ch. May 30, 2012) (V.C. Parsons)

In this case, the court considered claims related to (1) a repurchase option under the limited liability company agreement of plaintiff, a Delaware limited liability company

(the "Company Agreement"), for defendant's subscription units, and (2) a call right under defendant's employment agreement that provided that defendant's restricted units would be forfeited and transferred back to the plaintiff upon defendant's termination for cause under the employment agreement. The employment agreement contained a choice of law and forum selection provision selecting the laws and courts of New Mexico, and, therefore, the court was an improper forum to determine plaintiff's claim under the employment agreement. With respect to the claim under the Company Agreement, the court declined to bifurcate the case and stayed the action in favor of the related litigation pending in New Mexico even though the claim arguably involved issues concerning the internal affairs of a Delaware business entity. The dispute was essentially over the alleged exercise of an equity option, which, although important to the capital structure and control of closely-held Delaware limited liability companies, "does not automatically preclude [the court] from considering obvious inefficiencies and common sense reasons" for permitting another competent court to hear the claim.

21. *Paul v. Delaware Coastal Anesthesia, LLC*, C.A. No. 7084-VCG (Del. Ch. May 29, 2012) (V.C. Glasscock).

    Plaintiff was a member of a Delaware LLC and challenged an action taken by the other members of such LLC by written consent that terminated plaintiff's membership interest. The LLC agreement provided that a member of the LLC could be terminated by vote of seventy-five percent of the holders of the LLC's membership interests. Plaintiff argued members could only vote their interests at a member meeting because certain provisions of the LLC agreement provided a procedure by which meetings would be held. The court, in reading the LLC agreement as a whole, held that the LLC agreement did not dictate the method by which votes terminating membership must be taken and certainly did not specifically disallow votes by written consent. Thus, the court held that the LLC agreement did not "otherwise provide" so as to preempt actions by written consent as permitted by Section 18-302 of the LLC Act.

22. *Brinckerhoff v. Enbridge Energy Co., Inc.*, C.A. No. 5526-VCN (Del. Ch. May 25, 2012) (V.C. Noble).

    On remand by order of the Delaware Supreme Court to determine the sufficiency of the plaintiff's claims for reformation or rescission on a motion to dismiss, the Court of Chancery first concluded that the plaintiff's request for reformation or rescission was waived because the plaintiff failed to raise any arguments with respect to either remedy in his briefs or at oral arguments. Nevertheless, because of uncertainty surrounding the scope of the remand order, the Court of Chancery also addressed the substance of the plaintiff's claim for reformation or rescission.

    Turning to the plaintiff's claim for reformation, the court found that the plaintiff stated a claim that was potentially remediable through reformation. The partnership agreement permitted conflicted transactions that were "fair and reasonable" to the Partnership, and the partnership agreement deemed transactions that were "no less favorable to the Partnership than those generally being provided to or available from unrelated third parties" to be fair and reasonable. The court noted that it has previously interpreted

similar language to require something akin, if not equivalent to, entire fairness review. Because the entire fairness standard cannot be satisfied by reliance on an investment banker's opinion on a motion to dismiss, the court concluded that the plaintiff had adequately plead that the joint venture was not fair to the Partnership.

The court noted, however, that the reformation that the plaintiff sought—a reduction in Enbridge's share in the joint venture—was rarely sought and obtained. The court expressed hesitation because, by reducing Enbridge's share in the joint venture, the reformation remedy sought would reduce the cash flow Enbridge would receive and essentially redirect it to the Partnership, a result the court likened to garnishment. Despite its misgivings, the court concluded that because the partnership agreement only provided exculpation against money damages, and because the plaintiff adequately plead entitlement to an equitable remedy, the plaintiff's claim for reformation should survive a motion to dismiss.

Next, the court held that the plaintiff had not stated a claim for rescission. The court noted that the plaintiff made no arguments in favor of rescission and its counsel conceded at oral argument that reformation was the crux of this remand. In addition, the court found that the plaintiff failed to meet its burden of demonstrating that all parties to the transaction could be restored to the positions they occupied prior to the transaction. The plaintiff offered no explanation regarding how the court could rescind a joint venture agreement to construct a pipeline once such construction was complete. The court therefore dismissed the plaintiff's claim for rescission.

23. *Whittington, II v. Dragon Grp., LLC*, C.A. No. 2291-VCP (Del. Ch. May 25, 2012) (V.C. Parsons)

Plaintiff was a member of a Delaware LLC and filed actions against the LLC and the other members of the LLC seeking, among other things, recognition of his status as a member of the LLC. While litigating the substantive claims in this litigation, the other members of the LLC authorized the LLC to pay the legal fees incurred to "defend the members and the LLC against actions attempting to diminish their share and force [plaintiff] on the LLC as a member." Pursuant to this authorization, the LLC paid the legal fees for itself and the defendant members. Plaintiff claimed that because he was ultimately found to be a member of the LLC, he was also entitled to have his attorneys' fees paid by the LLC or, alternatively, that the payment of the defendant members' attorneys' fees by the LLC was a de facto distribution and, therefore, he was entitled to his pro rata share of that distribution.

The court found that, because the authorization was for legal fees to "defend" the members, it could not have been intended to include plaintiff. Thus, the court found that plaintiff was not entitled to payment of his attorneys' fees. The court noted that under Delaware LLC law, members of an LLC may authorize the payment of attorneys' fees for all or a subset of the LLC's members so long as such action is not contrary to the terms of the LLC agreement. Because nothing in the LLC agreement prohibited payment of attorneys' fees and the authorization was given by the requisite number of members of the LLC, the court found that it was not invalid on its face and thus it would not be

appropriate to treat the payments made pursuant to the authorization as a de facto distribution. The court noted that plaintiff could still pursue a claim that the defendant members' decision to reimburse their own attorneys' fees was wrongful.

24. *In re Cencom Cable Income Partners, L.P. Litig.*, C.A. No. 14634-VCN (Del. Ch. May 24, 2012) (V.C. Noble)

Following an appeal of an earlier decision by the Delaware Court of Chancery in favor of defendants (*see In re Cencom Cable Income Partners, L.P. Litig.*, C.A. No. 14634 (Del. Ch. June 6, 2011), the Delaware Supreme Court remanded the case to the Chancery Court with directions to answer the following questions: (1) since there was no amendment to the partnership agreement, on what legally authorized basis could the sale transaction have been structured to preclude limited partners from receiving quarterly distributions without the consent of all limited partners; and (2) if the partnership agreement gave all limited partners a contract right to quarterly distributions that was indefeasible without their consent, why, as a matter of contract or statutory law, would the non-consenting limited partners not be entitled to receive both interest payments and quarterly distributions during the period between the effective date of the sale and the termination of the partnership.

With respect to the first question, the court noted that the partnership agreement conferred upon the general partner the right to determine the terms of any sale of the assets of the partnership as part of partnership's liquidation process. Based on this authority, the court found that the manner in which the general partner structured the sale transaction was within its discretion. Further, the sale transaction was subject to approval by a majority of the limited partners, which approval was knowingly and voluntarily given by such majority. The court noted that the right to quarterly distributions could not be terminated without a unanimous vote to amend the partnership agreement, but found that such right was not terminated. Rather, following the sale transaction, the partnership had no cash available to pay these distributions because the sale transaction was structured to provide the purchasing affiliates with the operating income from the assets subject to the sale transaction from and after the effective date of the sale, which left the partnership with no cash to make the required distributions.

With respect to the second question, the court found that pursuant to the terms of the sale transaction, the partnership surrendered its rights to operating income generated from the assets it sold, but in lieu of quarterly distributions, the purchasing affiliates agreed to make interest payments to the limited partners. According to the court, these covenants were mutual and could not be separated because the purchasing affiliates' promise to make interest payments to the limited partners was in consideration for their right to receive operating income from the purchased assets. The court held that even if the failure to make quarterly distributions was a breach of the partnership agreement, that would still not support double payment to the limited partners—payment of interest and quarterly distributions to limited partners—because the limited partners' entitlement to damages would be limited to damages that would put them in the "same place as . . . [they] would have been if the contract had been performed."

25. *Paron Capital Mgmt., LLC v. Crombie*, C.A. No. 6380-VCP (Del. Ch. May 22, 2012) (V.C. Parsons)

Plaintiffs, two individuals with expertise in the investment field, sued defendant Crombie for acts arising out of a fraud related to a quantitatively-based trading program allegedly developed by Crombie. After performing extensive due diligence on Crombie and his software program—based in part on false information provided by Crombie about his financial situation, employment history, and investment track record—plaintiffs entered into business with Crombie. The parties formed Paron Capital Management, LLC (Paron) in June 2010—Crombie was the Initial Manager and a member of Paron and plaintiffs were also members of Paron.

Paron received an audit request in 2011 from its regulator. As part of the audit, Crombie provided certain account statements, which had been utilized previously to confirm Crombie's investment track record. In reality, Crombie had fabricated the account statements. After suspecting that the account statements were fabricated, plaintiffs halted all Paron trading activities, confronted Crombie, contacted Paron's regulator, and informed Paron investors that trading had stopped and that the situation was under investigation.

After confirming that the statements were fabricated, plaintiffs removed Crombie as member and Initial Manager of Paron. Then, plaintiffs filed an action against Crombie alleging breach of fiduciary duty and fraud.

The court held that Crombie, in his capacity as manager of Paron, owed general fiduciary duties of loyalty and care to plaintiffs, members of Paron, and that Crombie had breached his duty of loyalty. Crombie owed a general duty of loyalty to plaintiffs because the parties had not abrogated the application of traditional fiduciary duties in the Paron LLC Agreement. Furthermore, Crombie did not contest plaintiffs' interpretation of the LLC Agreement that Crombie owed plaintiffs fiduciary duties of loyalty and care. The court held that Crombie breached the duty of loyalty that he owed plaintiffs by preparing fraudulent marketing materials for Paron (based on information he provided that was forged or fabricated) and by continuing to conceal material information about his investment track record, his past employment, and his personal financial situation while Paron was operational. Because Crombie continued to conceal these misrepresentations and took affirmative steps to continue his fraudulent activity by providing false account statements, the court found that Crombie, in his capacity as Paron's manager, breached the duty of loyalty owed to plaintiffs in their capacity as members of Paron.

The court also found that plaintiffs satisfied the elements of fraud: Crombie had made numerous false representations of fact to plaintiffs before forming Paron with them, Crombie intended for plaintiffs to rely on those misrepresentations in deciding whether to go into business with him, plaintiffs justifiably relied on Crombie after performing sufficient due diligence, and plaintiffs suffered damage as a result of the fraud perpetrated by Crombie.

The court awarded reliance damages for loans and costs advanced to Crombie and Paron, mitigation costs for having to participate in litigation that was a direct result of Crombie's fraudulent conduct, and lost earnings for both plaintiffs based on their historical earnings, as well as attorneys' fees and expenses.

26. *Dawson v. Pittco Capital Partners, L.P.,* C.A. No. 3148-VCN (Del. Ch. Apr. 30, 2012) (V.C. Noble)

Plaintiffs ("Plaintiffs") were minority holders of preferred membership interests (the "Preferred Interests") in LaneScan, LLC, a Delaware limited liability company ("LaneScan"), who brought various claims related to a merger (the "Merger") by LaneScan with Vehicle Safety and Compliance, LLC ("VSAC"), pursuant to which their Preferred Interests were severely diluted. Plaintiffs also held secured notes in LaneScan (the "Notes"). Defendants consisted of other preferred members of LaneScan (the "Investor Defendants") and directors appointed by such members (the "Director Defendants" and together with the Investor Defendants, "Defendants"). The Merger was proposed to the members of LaneScan by a letter (the "Letter") which explained LaneScan's dire financial circumstances and included a written consent to be executed by the members consenting to the Merger (the "Consent"). The Letter also stated that each LaneScan member would be required to contribute their Notes to VSAC (the "Compelled Contribution"). Further, the Consent included an amendment to the LLC agreement of LaneScan whereby the Return of Capital Provision (as defined below) would be eliminated in its entirety (the "Amendment"). The Director Defendants and the Investor Defendants, consisting of a majority of the board members and a majority of the holders of the Preferred Interests, as required under the terms of the LLC agreement of LaneScan, approved the Merger and, in connection therewith, the Compelled Contribution and the Amendment. Plaintiffs (1) claimed that Defendants did not have the power to effect the Compelled Contribution, (2) claimed that Defendants breached the LLC agreement of LaneScan in adopting the Amendment and breached certain duties to Plaintiffs in adopting the Amendment and approving the Compelled Contribution and (3) brought intentional misconduct and gross negligence claims relating to the Merger, the Compelled Contribution and the Amendment. It is important to note with respect to all of these claims that the court found that Defendants' motivation in approving the Merger, the Amendment and the Compelled Contribution was to salvage value from LaneScan, which according to the court, may have become insolvent if the Merger was not consummated.

Before addressing each of the foregoing claims by Plaintiffs, the court first rejected Plaintiffs' claim that the Investor Defendants constituted a control group, which could result in the Investor Defendants owing fiduciary duties to the minority equity holders of LaneScan. The court noted that a number of equity holders can collectively form a control group where those equity holders are connected in some legally significant way—e.g., by contract, common ownership, agreement, or other arrangement—to work together toward a shared goal, but found that Plaintiffs had not proven there was a legally significant connection between the Investor Defendants sufficient to establish a control group.

With respect to the Notes, Plaintiffs argued that Defendants did not have the power to effect the Compelled Contribution. Defendants countered that the Compelled Contribution could be effected in connection with the Merger without regard as to whether that power was express in the LLC agreement because a Merger may eliminate "vested rights" of equity holders of pre-merger entities, including those rights in the nature of debt. The court indicated that the cases cited by Defendants for this argument all involved rights related to equity interests (e.g., voting, options, preferences and dividends). The court said that parties to contracts are free to provide that contractual rights and obligations will not survive a merger, but they must do so in "clear and unambiguous terms." The court held that Plaintiffs had two separate relationships with LaneScan, one as holders of Preferred Interests and another as holders of the Notes, and that the Notes conferred a separate set of rights from those related to the Preferred Interests. The court found that neither the LLC agreement of LaneScan nor the Notes stated in "clear and unambiguous terms" that the Notes could be eliminated in connection with a merger. Although the Director Defendants argued that the LLC agreement of LaneScan gave them broad authority to manage LaneScan, the court found that such grant of broad authority did not constitute "clear and unambiguous" authority to eliminate the Notes. Similarly, the court found that a drag-along provision requiring members to "execute all documents containing the same terms and conditions as those executed by holders of Preferred Interests and as reasonably directed" in connection with a "Company Sale" (and Plaintiffs conceded that the Merger was a Company Sale) also was not "clear and unambiguous" so as to permit the Compelled Contribution. Defendants lastly argued with respect to the Notes that the Compelled Contribution was appropriate and permissible because LaneScan was approaching insolvency and the Notes would not have had any value if the Merger was not consummated. The court found that while this argument may be relevant in a fiduciary duty context, a company's financial distress does not grant its directors and owners powers they do not otherwise possess. Accordingly, the court granted Plaintiffs' request for a declaratory judgment that the Notes remain valid, enforceable and outstanding following the Merger.

The court next turned to the Amendment, which removed a provision providing in relevant part that "[n]otwithstanding anything to the contrary" in the LLC agreement of LaneScan, in the event of a Company Sale, the buyer shall cause LaneScan to distribute in cash to the holders of Preferred Interests an amount equal to their unreturned capital contribution (the "Return of Capital Provision"). The amendment provision of the LLC agreement provides that the LLC agreement could be amended by written instrument adopted by a majority of the board of directors of LaneScan (the "Amendment Provision"). Plaintiffs argued that Defendants breached the LLC agreement of LaneScan by eliminating the Return of Capital Provision in adopting the Amendment, essentially arguing that, because of the "notwithstanding" language in the Return of Capital Provision, the Amendment Provision did not apply to the Return of Capital Provision. The court held that this claim failed because the Amendment Provision was not inconsistent with the Return of Capital Provision and thus the board had the authority to amend the Return of Capital Provision pursuant to the Amendment Provision. Plaintiffs further argued that Defendants breached the implied covenant of good faith and fair dealing by adopting the Amendment. In citing prior implied covenant cases, the court stated that the implied covenant requires contracting parties to refrain from arbitrary or

unreasonable conduct which has the effect of preventing the other party to a contract from receiving the fruits of the bargain. The court indicated that even discretionary rights must be exercised in good faith. Further, the court mentioned that the implied covenant also acts to import terms into a contract to analyze unanticipated developments or to fill gaps. However, if the contract speaks directly to an issue in dispute, the court noted that the contract terms would control and the implied covenant would not apply. The court found that in this case there was no gap to fill in that the Amendment Provision granted broad power to the board to amend the LLC agreement of LaneScan. The court found that Plaintiffs' bad faith claim also failed because the directors were motivated to approve the Merger, the Amendment and the Compelled Contribution by the threat of LaneScan's insolvency.

The court next addressed Plaintiffs' claims that Defendants committed intentional misconduct in consenting to the Merger, the Compelled Contribution and the Amendment and that the Director Defendants were grossly negligent in approving the Merger. With respect to these claims, the court first assessed whether Defendants had any such duties. The LLC agreement of LaneScan provided that "[n]o Member, Director or Officer shall have any duty to any Member or [LaneScan], except as expressly set forth herein . . . . Except as expressly set forth herein . . . no Member, Director or Officer of [LaneScan] shall be liable to [LaneScan] or to any Member for any loss or damage sustained by [LaneScan] or any Member, unless the loss or damage shall have been the result of gross negligence, fraud or intentional misconduct of such Member, Director or Officer . . . ." The court referred to the *Fisk Ventures v. Segal*, C.A. No. 3017-CC (Del. Ch. May 7, 2008), case, which involved similar provisions, and found that the first sentence eliminated all duties that could be eliminated under the LLC Act and that the second sentence would apply only if other provisions in the LLC agreement created fiduciary or contractual duties, but the second sentence did not operate so as to create any duties. Thus, the court indicated, the second sentence was a "just in case" measure. In any case, the court found that even if Defendants were subject to a duty not to act with gross negligence and to refrain from intentional misconduct, those claims would fail because Plaintiffs did not properly plead a gross negligence claim and because intentional misconduct requires an examination of Defendants' state of mind and even assuming Defendants were conflicted and the deal process fell short of best practices, this was not direct proof of intentional misconduct. As noted above, the court found that Defendants' motivation for the Merger, the Amendment and the Compelled Contribution was to salvage value for LaneScan. Plaintiffs also brought fiduciary duty claims against an officer of LaneScan. However, although a provision in the LLC agreement of LaneScan expressly provided that the officers owed certain duties to LaneScan, the court found that those duties were owed to LaneScan only and not to the holders of Preferred Interests. Because Plaintiffs did not bring any derivative claims, these claims also failed.

Lastly, the court addressed Defendants' argument that the doctrine of laches should deny all of Plaintiffs' claims. The court stated that to prevail on this argument the court must find (i) that a plaintiff had knowledge of a claim, (ii) that the plaintiff had unreasonably delayed in bringing the claim and (iii) that prejudice resulted. Because Defendants failed to demonstrate any prejudice, the court denied Defendants' request.

27. *In re K-Sea Transp. Partners, L.P. Unitholders Litig.*, C.A. No. 6301-VCP (Del. Ch. Apr. 4, 2012) (V.C. Parsons).

In this subsequent decision pertaining to K-Sea's merger with Kirby Corporation, the Court of Chancery addressed the defendants' motion to dismiss the plaintiffs' complaint. The court first turned to the plaintiffs' claims that the Committee, the Board, K-Sea's general partner and the general partner of K-Sea's general partner breached their fiduciary duties and the K-Sea partnership agreement by approving the merger without evaluating the fairness or reasonableness of the payment for the IDRs and by relying on the "Special Approval" of the Committee, which was comprised of members who improperly held phantom units.

The court noted that the exculpation provisions of the K-Sea partnership agreement required the plaintiffs to demonstrate both that the defendants had breached the K-Sea partnership agreement or their fiduciary duties and, in doing so, acted in bad faith. Turning to the provisions of the K-Sea partnership agreement pertaining to mergers to determine what duties were owed, the court found that the agreement established only one contractual duty with respect to mergers: that K-Sea's general partner must exercise its discretion. The K-Sea partnership agreement permitted K-Sea's general partner to consider whatever factors it chose in exercising its discretion and imposed no requirement to determine that a merger be fair and reasonable. The court further noted that the K-Sea partnership agreement displaced traditional fiduciary duties that ordinarily would constrain K-Sea's general partner in exercising its discretion with a narrower duty not to exercise its discretion in a manner inconsistent with the best interests of K-Sea as a whole, which, according to the court, essentially amounted to a duty not to exercise its discretion in bad faith.

The court then turned to the K-Sea partnership agreement provisions pertaining to "Special Approval." The court rejected the plaintiffs' claim that if the phantom units granted to the members of the Committee rendered the "Special Approval" defective, then the defendants breached their fiduciary duties and the K-Sea partnership agreement by approving the merger in reliance on the defective "Special Approval." In the court's view, a failure to qualify for the "Special Approval" safe harbor did not make the defendants' conduct improper unless the defendants also failed to satisfy the otherwise controlling standard of review—namely, whether K-Sea's general partner exercised its discretion in good faith.

With respect to whether K-Sea's general partner exercised its discretion in good faith, the court found that the complaint alleged facts that could support a finding of bad faith. Specifically, the plaintiffs alleged that the Board caused K-Sea's general partner to refuse to consent to any transaction that did not include a separate payment for the IDRs and that the Board incentivized the Committee to approve the merger by granting the phantom units on the eve of negotiations. The court noted, however, that the K-Sea partnership agreement entitled K-Sea's general partner to a conclusive presumption of good faith whenever it acted in reliance on an expert opinion. The Committee relied on a fairness opinion and the court concluded that it would be unreasonable to infer that K-Sea's general partner did not also rely on the same opinion. Therefore, the court found,

K-Sea's general partner was conclusively presumed to have acted in good faith. The court also noted that the implied covenant of good faith and fair dealing could not be used to infer language that contradicts a clear exercise of an express contractual right. As a result, the court dismissed the plaintiffs' claims of breach of fiduciary duty and the K-Sea partnership agreement in connection with approval of the merger.

The court next turned to the plaintiffs' remaining claim alleging breach of the fiduciary duty of disclosure. The court noted that, because of the exculpation provision of the K-Sea partnership agreement, to state a claim the plaintiffs needed to allege facts to support a reasonable inference that the defendants, in authorizing a materially misleading disclosure, acted in bad faith. The plaintiffs first claimed that a statement in the Form S-4 that the consideration to be exchanged in the merger represented a 9.56% increase over the amount originally offered was misleading because a significant portion of that increase was allocated to the IDR payment. The court rejected this argument, noting that the Form S-4 contained a detailed discussion regarding the increase in the amount of consideration. The plaintiffs next contended that a statement in the Form S-4 that the members of the Committee would not personally benefit from the merger in a manner different from unitholders was materially misleading. The court rejected this argument and in doing so relied on its prior opinion, in which the court found this statement to be generally true and noted that the Form S-4 disclosed the grant of the phantom units. The court therefore dismissed the plaintiffs' disclosure claim.

28. *Lola Cars Int'l Ltd. v. Krohn Racing, LLC*, C.A. No. 6520-VCN (Del. Ch. Feb. 29, 2012) (V.C. Noble)

In this decision in a long-running dispute in the Court of Chancery, one member of a Delaware LLC ("Krohn") sought, pursuant to a motion for judgment on the pleadings, to require the other member ("Lola") to pay Lola's share of legal fees incurred by the LLC, on behalf of Krohn and the LLC's chief executive officer ("Hazell"), that Krohn had paid. Under the LLC's operating agreement, if the audited balance sheet of the LLC for any financial year showed negative net assets for the LLC, Lola was required to fund 51% of the amount of the negative net assets of the LLC. Krohn acknowledged that the LLC did not have an audited balance sheet but alleged that Lola's conduct had improperly prevented the preparation of an audited balance sheet. The court stated that if Lola had unjustifiably interfered with the effort to obtain an audit, Lola should not be able to benefit from the lack of an audit and avoid an obligation to provide additional funding to the LLC. However, the determination whether Lola was responsible for improperly preventing an audit was a factual matter that the court could not resolve on a motion for judgment on the pleadings. In addition, with respect to Hazell's legal fees, Lola argued that it could not be responsible for those fees because Hazell had no right to mandatory indemnification under the LLC's operating agreement. The court rejected this argument because, according to the court, the fact that an operating agreement could, but fails to, provide for mandatory indemnification does not preclude management of a Delaware LLC from deciding to provide an officer with assistance in paying legal fees arising out of work-related matters. The court held, again, that the determination of whether Hazell's legal fees were necessary and reasonable presented factual issues that could not be resolved on a motion for judgment on the pleadings.

29. *In re Estate of Everett T. Conaway*, C.A. No. 6056-VCG (Del. Ch. Feb. 15, 2012) (V.C. Glasscock)

In this declaratory judgment action, the petitioner asked the Court of Chancery to determine whether the terms of a limited partner's revocable trust and last will and testament superseded a transfer restriction in a limited partnership agreement and whether the petitioner validly withheld its consent pursuant to such transfer restriction. The petitioner, as trustee of a revocable trust, held a 30% limited partnership interest in EJKC Partnership, L.P. (the "Partnership"). Everett T. Conaway ("Everett"), as trustee of the Everett T. Conaway Revocable Trust (the "ETC Trust"), held a 69% limited partnership interest in the Partnership. Confam, Inc., the general partner of the Partnership (the "GP"), owned the remaining 1% interest in the Partnership. The petitioner and Everett each held 50% ownership stakes in the GP.

The limited partnership agreement of the Partnership provided that a limited partner could not transfer its interest in the Partnership without the consent of the GP and the non-transferring limited partner. In his will, Everett bequeathed household furnishings to the respondent and the rest, residue and remainder of his estate to the ETC Trust. The ETC Trust terminated upon receiving the remainder of Everett's estate and, under the terms of the ETC Trust, Everett's interest in the Partnership was to pass to the respondent. The terms of the ETC Trust further provided that the balance of the ETC Trust corpus and any accumulated income was to go to the petitioner.

Everett did not obtain the consent of the GP or the consent of the petitioner to the transfer of the Partnership interest to the respondent. After Everett's death, the petitioner filed this action and contended that, without the requisite consent, the purported transfer to the respondent was void and, as residuary beneficiary of the ETC Trust, it was sole owner of all interests, including the interest of the GP, in the Partnership. The respondent contended that the petitioner's withholding of consent to the transfer (i) constituted self-dealing and a breach of fiduciary duty, (ii) constituted an unreasonable restraint on alienation and (iii) ran afoul of Everett's intent as a testator.

After briefly discussing the contractual freedom afforded under DRULPA, the court found the language of the transfer restriction to be clear and unambiguous. As a result, the court concluded, the purported transfer to the respondent did not comply with the terms of the transfer restriction and was therefore invalid.

Turning to the respondent's arguments for invalidating the transfer restriction, the court declined to determine whether the petitioner's dual roles as a general and limited partner required it to meet fiduciary obligations when exercising its consent right in the context of a transfer because, even assuming the full panoply of fiduciary duties applied, mere exercise of a contractual right, the purpose of which was to preserve the original partnership structure absent unanimous consent, did not constitute a breach of fiduciary duty. The court also noted that it would be inequitable to conclude that by transferring his ownership interest in the GP to the petitioner, Everett could impose fiduciary obligations requiring the petitioner to consent to a transfer it would otherwise oppose pursuant to its contractual rights under the limited partnership agreement.

The court also concluded that the transfer restriction was not an unreasonable restraint on alienation. The purpose of the Partnership was to permit Everett to make transfers to the petitioner with limited tax consequences and the transfer restriction sought to preserve this purpose. The court also found unpersuasive the respondent's argument that Everett's intent as a testator should control. The court noted that a testator's intent controls interpretation of a testator's will. Such intent, however, cannot change preexisting contractual obligations. Thus, according to the court, Everett's subsequent amendment to his testamentary scheme could not invalidate his pre-existing contractual obligations pursuant to the limited partnership agreement of the Partnership.

30. *Jagodzinski v. Silicon Valley Innovation Co., LLC*, C.A. No. 6203-VCP (Del. Ch. Feb. 14, 2012) (V.C. Parsons)

In an earlier proceeding in this case, the court order defendant LLC to provide plaintiff with access to books and records pursuant to LLC Act Section 18-305 and the LLC's LLC agreement. After the LLC failed to comply with the court's original order and two subsequent contempt orders, plaintiff brought a motion for the appointment of a receiver for the LLC with broad powers over the LLC, its operations and management, including the power to (i) investigate and pursue claims and causes of action belonging to the LLC and to bring suit thereon to the extent the claims are against third parties and (ii) defend against third party claims. The LLC failed to respond to plaintiff's motion.

The court noted that, in circumstances prior to the cancellation of the LLC's certificate of formation and in which the LLC's agreement does not address the issue, the court has the authority in the exercise of its inherent equitable power to appoint a receiver for an LLC. In support of this determination, the court referred to Section 18-1104 of the LLC Act, which provides that in any case not provided for the LLC Act, the rules of law and equity shall govern. The court stated that the appointment of a receiver is an extraordinary remedy that should be undertaken cautiously and only as necessitated by the exigencies of the case. In this case, the court determined that appointment of a receiver was warranted based on the repeated failure of the LLC to comply fully with the court's previous orders. However, the court limited the receiver's authority to curing the LLC's contempt by effecting the production of books and records previously ordered by the court. The court denied plaintiff's request for a receiver with the authority to conduct the LLC's business and pursue any claims belonging to the LLC because such relief would exceed the scope of the contempt that gave rise to the appointment.

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