2014 SPRING MEETING
OF
ABA SECTION OF BUSINESS LAW

2014 Review of LLC Case Law Developments

2014 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. *Touch of Italy Salumeria & Pasticceria, LLC v. Bascio*, C.A. No. 8602-VCG (Del. Ch. Jan. 13, 2014) (V.C. Glasscock)

Three individuals formed an LLC, the business of which was to operate an Italian grocery in Rehoboth, Delaware. The business was successful. However, one of the defendants decided to withdraw as a member of the LLC and gave notice pursuant to the LLC Agreement, which provided that any member could withdraw after giving written notice to the other members. The withdrawing member allegedly told the remaining members that he intended to move to Pennsylvania and possibly start a new business there. However, ten weeks after he withdrew from the LLC, he opened a competing Italian grocery on the same block as the original Italian store. Plaintiffs sued and defendants filed a motion to dismiss, the subject of this opinion.

The court first addressed plaintiffs' breach of contract claim, looking to the LLC Agreement itself to determine if defendant had breached the agreement. The court determined that the LLC Agreement provided a mechanism for voluntary withdrawal and did not contain a non-compete provision. Further the court found that plaintiffs did not refer to any specific provision of the LLC Agreement in support of their allegation of breach of the agreement. Therefore, the court dismissed this claim.

The court also dismissed plaintiffs' claims of fraud and misrepresentation because plaintiffs did not adequately plead any reliance on defendant's representations to their detriment in the complaint.

The court analyzed plaintiffs' allegation that defendant breached the implied covenant of good faith and faith dealing, which prevents a party from denying his or her contractual partners the benefit of their bargain based on circumstances that the parties did not anticipate. However, the court found that member withdrawal was specifically anticipated by the parties in the LLC Agreement, which provided for voluntary member withdrawal. Further, the parties omitted a covenant not to compete in their LLC agreement, a "staple of employee contracts," which "omission the [p]laintiffs obviously now regret." The court refused to use the implied covenant to shoehorn a covenant not to compete into the parties' contract and dismissed this claim.

The court also dismissed plaintiffs' allegation that defendant breached his fiduciary duty to the LLC by making arrangements to open a competing business while he was still employed by the LLC. The court found that plaintiffs did not include any inferences supporting the conclusory allegation of breach of fiduciary duty in their complaint. Further, defendant would have owed no duties to the LLC in the ten weeks after he left the LLC until he opened his competing business.

Finally, the court dismissed plaintiffs' conversion claim because they failed to identify any specific property that defendant allegedly converted.

2. *Grace v. Ashbridge LLC*, C.A. No. 8348-VCN (Del. Ch. Dec. 31, 2013) (V.C. Noble)

The plaintiff is the co-trustee of a family trust that held shares in Ashbridge Corporation, a Pennsylvania corporation (the "Corporation"), which was merged with and into a

Delaware LLC, later named Ashbridge LLC, the defendant. The plaintiff is member of the defendant, a manager serving on its Board of Managers, and its chairman. The plaintiff was also a shareholder of the Corporation, as well as the chairman and a member of its governing board.

The family trust's beneficiaries filed objections to trustee accountings in the Court of Common Pleas of Chester County, Pennsylvania, Orphans' Court Division, alleging, in part, breaches of fiduciary duty by the trustees and diminution in value of the trust's interest in the Corporation due to imprudent investments, improper loans, and self-dealing transactions by the plaintiff (the "Orphans' Court Proceeding"). The objections were directed at various acts of mismanagement involving the Corporation and an affiliate entity, but not the defendant.

The plaintiff filed this lawsuit (the "Delaware Action") seeking indemnification and advancement for expenses related to the Orphans' Court Proceeding, a failed mediation (the "Mediation"), and the Delaware Action. The plaintiff averred he was entitled to advancement and indemnification under the defendant's operating agreement because it provided that persons holding an office, or otherwise having a relationship, with the defendant or one of its managers or members would be entitled to indemnification and advancement.

The defendant moved to dismiss the Delaware Action for failure to state a claim because the plaintiff's acts relating to the Orphans' Court Proceeding were taken in the plaintiff's personal capacity or in his capacity as an officer of the Corporation or its affiliate and not in any capacity relating to the defendant. Because the plain terms of the indemnification and advancement provision did not extend to predecessors or affiliates, the defendant was not required to indemnify or advance expenses for any acts not taken on behalf of the defendant.

The court held that successor entities are generally not liable for the actions of corporate officers of predecessor entities or affiliates when a fundamental change in identity has occurred. For purposes of advancement and indemnification, the court held that Delaware law considers a conversion from an LLC to a corporation to be a fundamental change in identity: mandating indemnification when corporate directors and officers successfully defend themselves, but for LLCs, leaving indemnification to the terms of the operating agreement. The court ruled that the conversion from Ashbridge Corporation to Ashbridge LLC was a fundamental change in identity, remarking that the indemnification rights in the defendant's operating agreement were different from those found in the Corporation's bylaws. The defendant was therefore not liable for the acts of its predecessor corporation simply because it was the successor entity; however, the court noted that it was expressing no opinion upon whether a successor entity could be responsible for indemnifying or granting advancement based upon the bylaws or operating agreement of a predecessor entity because the plaintiff never properly presented that allegation.

Thus, in order to prevail, the plaintiff had to prove that the defendant's indemnification and advancement provisions applied retroactively to predecessor entities or affiliates.

The court held that because the Orphans' Court Proceeding involved only the defendant's predecessor and affiliate, and the plain terms of the defendant's operating agreement did not provide for retroactive indemnification or advancement for its predecessor entities or affiliates, the plaintiff was not entitled to indemnification. The court also held that no indemnification was due for expenses of the Mediation because the plaintiff failed to plead any facts explaining his entitlement to relief. Finally, because the plaintiff was denied indemnification and advancement for the Orphan's Court Proceeding or the Mediation, he was not entitled to indemnification or advancement for the Delaware Action.

3. *Graven v. Lucero*, C.A. No. 8919-VCN (Del. Ch. Dec. 20, 2013) (V.C. Noble)

   This decision was rendered in response to a motion for summary judgment in a summary proceeding in the Court of Chancery to determine the rightful controller of a Delaware LLC. Plaintiff claimed that a vote by the LLC's founding principals removed defendant from his position as managing principal and inserted plaintiff into such position. The dispute in this case arose from a disagreement as to which members of the LLC were founding principals and thus entitled to vote on the removal and appointment of the LLC's managing principal. The LLC's operating agreement identified the founding principals, but plaintiff and defendant differed as to which version of the operating agreement was in effect at the time of the vote. The version of the operating agreement believed by defendant to be the effective operating agreement listed a different set of founding principals than the founding principals set forth in the version of the operating agreement plaintiff asserted to be in effect. The court denied summary judgment, ruling that a genuine issue of material fact existed as to which version of the operating agreement was the final executed version.

4. *Huatuco v. Satellite Healthcare*, C.A. No. 8465-VCG (Del. Ch. Dec. 9, 2013) (V.C. Glasscock)

   The plaintiff, a member of Satellite Dialysis of Tracy LLC, a Delaware LLC (the "Company"), filed a complaint against the Company and its other member, Satellite Health Care ("Satellite"), seeking judicial dissolution of the Company on the basis of a deadlock between the plaintiff and Satellite (each owning 50% of the Company member interests). In response, the defendants moved to dismiss for failure to state a claim. Although the complaint alleged that the defendants breached the Company's LLC agreement (the "Agreement"), the court found that the parties had agreed that the motion to dismiss was not reliant on the underlying facts alleged in the complaint, but rather on whether the plaintiff would be entitled to judicial dissolution based on the interplay of LLC Act Section 18-802 and certain provisions of the Agreement.

   The court held that the terms of the Agreement precluded the plaintiff from seeking judicial dissolution. Citing *R&R Capital, LLC v. Buck & Doe Run Valley Farms, LLC*, 2008 WL 3846318 (Del. Ch. Aug. 19, 2008), and the broad policy of freedom of contract underlying the LLC Act, the court held that judicial dissolution is a default rule which may be displaced by contract. Here, the Agreement included the following provision: "Except as otherwise required by applicable law, the Members shall only have the power

to exercise any and all rights expressly granted to the Members pursuant to the terms of this Agreement." The court found that this applied to member rights generally—which included the right to seek judicial dissolution.

As the Agreement did not expressly provide any right to judicial dissolution and because judicial dissolution was a default rule, and so not included by virtue of the clause, "as required by applicable law," the court concluded that judicial dissolution was intentionally excluded and was not available to the plaintiff.

5. *Costantini v. Swiss Farm Stores Acquisition LLC*, C.A. No. 8613-VCG (Del. Ch. Sept. 5, 2013) (V.C. Glasscock); *Costantini v. Swiss Farm Stores Acquisition LLC*, C.A. No. 8613-VCG (Del. Ch. Dec. 5, 2013) (V.C. Glasscock)

In this case, plaintiffs, Edmond D. Costantini, Jr. ("Constantini") and James Kahn ("Kahn"), sought indemnification for their fees and costs in underlying litigation involving defendant, Swiss Farm Stores Acquisition LLC ("Swiss Farm"). In the underlying litigation, Swiss Farm sought damages against Costantini and Kahn for alleged breaches of fiduciary duty, but the court dismissed that action based on laches. In this decision, the court ruled on a motion for judgment on the pleadings brought by Costantini and Kahn seeking indemnification for their fees and costs incurred in defending the fiduciary duty action. Because Costantini was a member of the board of managers of Swiss Farm and Kahn was not, the court examined their indemnification claims individually.

With respect to Constantini's claim for indemnification, the court cited to the public policy underlying the grant of indemnification to corporate directors, officers and agents of under the DGCL, which is to encourage able people to serve in those positions. The court stated that the same policy reasons supporting indemnification of corporate actors apply to actors for other entities, including LLCs such as Swiss Farm. The court went on to state that, because LLCs are creatures of contract, the LLC Act provides broad latitude for LLCs to allocate the rights and responsibilities of its members. In this case, Swiss Farm, however, chose to import into its Operating Agreement, near verbatim, the permissive and mandatory indemnification rights for members of its board of managers, officers, employees and agents as provided to corporate actors in DGCL Section 145. Because Constantini was sued in his capacity as a member of Swiss Farm's board of managers, the court held that Swiss Farm's Operating Agreement unambiguously provided indemnification to Costantini under the undisputed facts in this case and thus granted Constantini's motion for judgment on the pleadings.

With respect to Kahn's claim for indemnification, the court stated that the parties had conceded that Kahn was not a member of the Swiss Farm board of managers and was not an officer, employee or agent of Swiss Farms. Kahn was apparently sued for breach of fiduciary duty in his capacity as a partner of a partnership that in turn was a member of Swiss Farm, which partnership had the right in its capacity as a member to appoint a member of the Swiss Farm board of managers. The court held that because Kahn did not fall within the categories of persons granted indemnification under the Swiss Farm

Operating Agreement, he was not entitled to indemnification and therefore denied Kahn's motion for judgment on the pleadings.

In a subsequent decision in this case, the court ruled on Kahn's motion for reargument on the issue of whether Kahn was an agent of Swiss Farm. With his motion for reargument, Kahn submitted evidence claiming that he was an agent of Swiss Farm through certain brokerage and development management contracts his company had entered into with Swiss Farm. Because the indemnification clause in the Swiss Farm Operating Agreement borrowed language from Section 145 of the DGCL—indemnifying any person who was sued "by reason of the fact that he was an agent"—the court established that case law interpreting Section 145 was relevant to interpreting the clause's scope. The court's analysis, using DGCL precedent, found that the clause indemnified only agents whose agency position had a "causal connection or nexus" with the complained of act. In other words, one's agency capacity must have been "necessary or useful" to accomplish the act forming the basis of the underlying lawsuit. The court found that Khan had not sufficiently demonstrated that he was an agent of Swiss Farm or that the alleged breaches of fiduciary duty were sufficiently related to his claim of agency. The court thus denied Kahn's motion for judgment on the pleadings.

6. *Fillip v. Centerstone Linen Servs., LLC*, C.A. No. 8712-ML (Del. Ch. Dec. 3, 2013) (Master LeGrow)

The plaintiff, Karl Fillip, was the former CEO of defendant Centerstone Linen Services, LLC (the "Company"). After resigning from his position as CEO, the plaintiff sued the defendant, alleging he was entitled to a severance payment which was refused by the defendant. The defendant filed counterclaims and affirmative defenses alleging, in part, breach of fiduciary duties and breach of contract. The plaintiff contended he was entitled to advancement of the fees and expenses he incurred as a result of the various claims, counterclaims, motions, and affirmative defenses related to the litigation.

Seeking to avoid advancement, the defendant dismissed its breach of fiduciary duties claims, arguing that no advancement was due for the remaining breach of contract allegations. The defendant maintained that the plaintiff's advancement right was limited to expenses related to claims for fraud or bad faith, and even if not so limited, no advancement was required because the breach of contract claims were personal, thus not related actions taken "in the performance of his duties" as an officer of the Company. This advancement dispute was before the court on summary judgment.

The indemnification provision of the defendant's LLC operating agreement provided:

> The Company shall indemnify, defend and hold harmless each Manager and Officer for all costs, losses, liability, and damages whatsoever paid or incurred by such Manager or Officer in the performance of his duties in such capacity . . . to the fullest extend provided or permitted by [law]. Further, in the event fraud or bad faith claims are asserted . . . the Company shall nonetheless bear all of the aforesaid expenses subject to the obligation of such

> Manager or Officer to repay all such expenses if they are finally determined to have committed such [acts].

Reading the indemnification provision as a whole, the court held that the word "defend" in the first sentence of the indemnification provision created a mandatory advancement right. The court noted that a reference to "defend" is distinct from "indemnify and hold harmless," creating a duty to pay for defense on a current basis, thus a duty to advance expenses. The court found that the second sentence of the indemnification provision in this context did not create an independent advancement right, but merely clarified advancement rights created in the first sentence, which continued to apply when a manager or officer faced claims of fraud or bad faith.

The court also rejected the defendant's assertion that the phrase, "in the performance of his duties in such capacity," created a narrower advancement right than the "by reason of the fact" standard found in corporate law under DGCL Section 145. The "by reason of the fact" standard means that when a corporate officer uses his official power in the commission of alleged misconduct, a nexus exists between the underlying proceeding and one's official capacity—that proceeding is "by reason of the fact" that one was a corporate officer. The court here found no substantive distinction between "in the performance of his duties in such capacity" and "by reason of the fact," remarking that both can be reconciled as encompassing wrongdoing committed by an officer in his official capacity and in the performance of his daily managerial duties. Moreover, since the indemnification provision permitted indemnification to fullest extent permitted by law, "in the performance of his duties in such capacity" was not read to be any narrower than the "by reason of the fact" standard.

Ultimately, the court ruled that use of the word "defend" in the indemnification provision extended mandatory advancement rights to the plaintiff for all expenses incurred in litigation related to actions taken by the plaintiff as CEO of the Company, including the breach of contract claims that were based on the plaintiff's actions taken in the performance of his duties.

7. *DV Realty Advisors LLC v. Policemen's Annuity & Benefit Fund of Chicago*, No. 547, 2012 (Del. Aug. 26, 2013) (*en banc*); *Policemen's Annuity & Benefit Fund of Chicago v. DV Realty Advisors LLC*, C.A. No. 7204-VCN (Del. Ch. Nov. 27, 2013) (V.C. Noble)

In an appeal before the Delaware Supreme Court of a decision by the Court of Chancery validating the removal of the general partner of a Delaware limited partnership (the "Partnership"), the general partner raised two issues: that the Court of Chancery improperly found that the limited partners (the "LPs") believed in good faith that removing the general partner was in the best interests of the Partnership and that certain "red flags" raised by an advisor to the Partnership did not sufficiently support the court's finding that the LPs removed the general partner in good faith. The Delaware Supreme Court affirmed the Court of Chancery's judgment.

The Supreme Court initially stated that reviewing a conclusion of good faith involved both questions of law and fact—the ultimate determination is one of law, while the basis

for that determination is factual and must be clearly erroneous to be overturned. In analyzing the definition of good faith, the Supreme Court stated that the term "good faith" was undefined; however, it had never held that the UCC definition of good faith, applied in this case by the Court of Chancery below, applied to limited partnership agreements ("LPAs"). Instead, the Supreme Court held that the application of the definition of good faith utilized in *Brinckerhoff v. Enbridge Energy Company, Inc.* was appropriate in this case. *Brinckerhoff* stated that actions were not taken in good faith if they were "so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith."

In this case, the partnership agreement required the LPs to determine, in good faith, that removing the general partner was "necessary in the best interest of the [Partnership]." In addressing the first issue, the Supreme Court found the record showed that the general partner repeatedly breached its contractual obligations under the partnership agreement to deliver timely audited financial statements. Therefore, the Supreme Court found that the Court of Chancery was correct in determining that this failure by the general partner provided the LPs with a good faith belief that it was necessary in the best interest of the Partnership to remove the general partner as general partner. However, because the good faith standard in the partnership agreement was "purely subjective," the Supreme Court stated that the Court of Chancery's determination that the standard included elements of objectivity was incorrect. This incorrect determination, however, did not change the outcome. The Supreme Court did not address the second issue because it found that the LPs had a sufficient good faith basis for removing the general partner based on its failure to delivery timely audited financial statements.

In a follow-on decision, the Court of Chancery was presented with the question of whether the general partner became a limited partner of the Partnership upon its removal or, alternatively, retained only an economic interest in the Partnership. In addressing this issue, the court first noted that under DRULPA, unless a partnership agreement provides otherwise, a person may be admitted to a partnership as a limited partner only upon the consent of all of the limited partners. Because none of the limited partners consented to the general partner being admitted as a limited partner upon its removal as general partner, the court found that there was no statutory basis for the former general partner's position that it became a limited partner upon its removal. Turning to the LPA, the court considered the removal provisions which provided that in the event the general partner was removed, the general partner would retain its capital account with half of such capital account to be distributed within thirty days of removal and the other half to be maintained on the same basis as any other limited partner's capital account. The court found that, for such a major issue in partnership governance, these provisions could not be read to provide that the general partner would become a limited partner upon its removal. Thus, the court held that upon its removal the general partner had only an economic interest in the Partnership. In its holding, the court noted that its interpretation of the LPA was consistent with revenue laws pursuant to which a former partner would be treated as a partner for tax purposes.

The court also addressed whether the proper date for valuing the removed general partner's capital account should be the first valuation date following the general partner's

removal or, as argued by the removed general partner, a date that preceded the general partner's removal. The LPA did not provide any express guidance on the timing of valuation, and the court found that the focus must be on reasonableness and that the first valuation date following removal more accurately reflected the economic realities at the time of removal. The removed general partner further sought to add to its capital account for a loan for which it was a co-borrower with the Partnership and for a guarantee provided by a principal of the removed general partner. The LPA provided that the capital account of a partner would be increased by the amount of any of the liabilities of the Partnership that were assumed by a partner. Because the removed general partner was a co-borrower on the loan and not ultimately liable (it was entitled to contribution from the Partnership) and because the guarantee was not made by the general partner itself, neither the loan nor the guarantee was determined to have increased the removed general partner's capital account.

8. *Northside Cmty. Bank v. Friedman*, C.A. No. 8405-VCG (Del. Ch. Nov. 20, 2013) (V.C. Glasscock)

Two defendants, who were individuals that personally guaranteed a loan made by plaintiff bank, allegedly created multiple Delaware entities, including an LLC, a limited partnership and two corporations, as part of a plan to fraudulently transfer assets beyond the bank's reach with the help of a third defendant, who allegedly facilitated the fraudulent transfers. The defendants moved to dismiss the bank's allegations of fraudulent transfer for lack of personal jurisdiction.

Upon learning that the loan they had personally guaranteed was going into default, the guarantors allegedly established a labyrinth of Delaware entities and, with the help of the third defendant, transferred their assets into certain of those entities and used other entities to hold and transfer interests in those entities.

In analyzing the defendants' motion to dismiss for lack of personal jurisdiction, the court first found that it had personal jurisdiction over the two defendants who guaranteed the bank loan under Delaware's long-arm statute, which gives the court jurisdiction over any nonresident who, either in person or through an agent, transacted any business in Delaware. The court stated that the allegations that the guarantors made corporate filings with the Delaware Secretary of State through an agent to form Delaware entities and transferred their assets into these entities were sufficient to make a prima facie case that the guarantors engaged in business transactions in Delaware. Further, the court found that the transfer of the assets into these Delaware entities arose out of the forum transactions and that exercising personal jurisdiction over the guarantors in these circumstances did not offend due process.

Second, the court found that it had personal jurisdiction over the third defendant, who facilitated the alleged fraudulent transfers by acquiring ownership interests in the Delaware entities and serving as a director of the Delaware corporations, under the conspiracy theory of jurisdiction because the bank sufficiently alleged facts to support an inference that the conspiracy elements were satisfied.

Finally, the court also found that it had personal jurisdiction over certain non-Delaware trusts under the conspiracy theory of jurisdiction. The non-Delaware trusts, which were created for the benefit of the guarantors' children, acquired interests in the Delaware entities formed by the guarantors. The court stated that a nonresident co-conspirator transacts business in Delaware under the long-arm statute when its alleged co-conspirators transacted business in Delaware. The court attributed the acts of the guarantors to the trusts as co-conspirators and found that the exercise of personal jurisdiction over the trusts was appropriate.

9. *Barton v. Club Ventures Invs. LLC*, C.A. No. 8864-VCN (Del. Ch. Nov. 19, 2013) (V.C. Noble)

Plaintiff, David Barton ("Barton"), was a member and former employee of defendant, Club Ventures Investments LLC ("CVI"), a Delaware LLC. Barton entered into a Confidentiality, Non-Competition and Intellectual Property Agreement (the "Non-Compete Agreement") with CVI in 2005. CVI, Barton and certain other members then entered into an Amended and Restated Limited Liability Company Agreement (the "LLC Agreement") in 2011 that CVI executed as the "Company" and Barton and other members executed as "members." The LLC Agreement contained a covenant restricting Barton from opening or operating "any new fitness facility (or otherwise license the name 'David Barton Gym' or any variation thereof) without the written consent of [certain other Members]."

Barton eventually left CVI and filed this lawsuit seeking a declaratory judgment that he was not subject to any non-compete agreement with CVI. In response, CVI agreed not to enforce the restrictive covenant in the LLC Agreement to the extent it would be construed as a non-compete, but CVI claimed the Non-Compete Agreement was still effective. Barton moved for partial summary judgment on the question of whether the LLC Agreement superseded the Non-Compete Agreement by way of the LLC Agreement's merger and integration clause (the "Integration Clause"), the last sentence of which reads: "All prior agreements among the Members are superseded by this Agreement, which integrates all promises, agreements, conditions, and understandings among the Members with respect to the Company and its property."

Barton asserted that the Integration Clause unambiguously renders any prior agreement, e.g., the Non-Compete Agreement, inoperative and non-binding. In response, CVI contended that (i) since it did not sign the LLC Agreement as a "Member" and Barton did not sign the Non-Compete Agreement as a "Member," the Non-Compete Agreement was not an agreement among Members as contemplated in the Integration Clause and (ii) the Integration Clause did not apply because the Non-Compete Agreement covered a different subject matter than does the LLC Agreement. The court held, inter alia, that the Integration Clause clearly and unambiguously provides that it supersedes prior agreements among "Members" as such term is defined in the LLC Agreement and since the Non-Compete Agreement was between a Member, Barton, and a non-Member, CVI, the LLC Agreement did not supersede the Non-Compete Agreement.

10. *AM Gen. Holdings LLC v. The Renco Grp., Inc.*, C.A. No. 7639-VCN (Del. Ch. Oct. 31, 2013) (V.C. Noble)

In its fourth decision in this series of related cases, the court addressed motions for summary judgment from both the plaintiff and the defendants.

The court first addressed the plaintiff's motion for partial summary judgment on its claim that ILR Capital LLC ("ILR"), the managing member of Ilshar Capital LLC ("Ilshar"), breached its obligations under the Ilshar LLC Agreement by making "Prohibited Investments." The court found that the Ilshar LLC Agreement unambiguously prohibited Ilshar from acquiring or holding an interest in any entity in which either The Renco Group, Inc. ("Renco") or a Renco affiliate had an interest. The court then considered evidence that the defendants' admitted a "possible violation" of the Prohibited Investments by providing certain compliance certificates. However, plaintiff submitted no further evidence of a violation. The court viewed the evidence submitted in the light most favorable to the defendants, as non-moving parties, and denied the plaintiff's motion for summary judgment.

The court then addressed the defendants' motion to dismiss various claims made by the plaintiff. The court dismissed the plaintiff's claims that defendants' breached certain fiduciary duties. The court noted that, where a dispute arises from obligations addressed by a contract, fiduciary claims that arise from the same facts are foreclosed unless the fiduciary duty claims depend on additional facts, are broader in scope and involve different considerations in terms of a potential remedy. Because the plaintiff's claims that the defendants breached their duties of loyalty and care arose out of obligations the defendants owed under the Ilshar LLC Agreement and a contribution agreement, and the plaintiff failed to allege distinct harms outside of the scope of those contractual agreements, the court dismissed the plaintiff's breach of fiduciary duty claims and the related aiding and abetting claims. The court also dismissed plaintiff's claims of tortious interference, unjust enrichment and conversion and for indemnification.

The court did not dismiss, however, the plaintiff's claim that it was entitled to certain distributions, noting that the claim was not moot as suggested by the defendants because the preliminary injunction granted previously on the issue did not provide the plaintiff permanent relief.

11. *Zimmerman v. Crothall*, C.A. No. 6001-VCP (Del. Ch. Oct. 14, 2013) (V.C. Parsons)

After a full trial in this case, the court had earlier issued an opinion holding that defendants breached the operating agreement of Adhezion Biomedical LLC, a Delaware LLC (the "Company"), by entering into certain transactions without first obtaining the approval of the Class A unitholders of the Company but, because the court found that the breach caused no damage to the Company, the court awarded nominal damages of $1. At the conclusion of its opinion, the court directed the parties to confer and submit a final, post-trial order. After the parties later failed to agree on a form of final order, plaintiff moved for entry of his proposed final order. Plaintiff later sold all of his units in the Company before the court ruled on his motion. Defendants then moved to dismiss this

derivative action, arguing that the sale of all of plaintiff's interests in the Company prior to the entry of a final judgment extinguished his standing to prosecute claims derivatively on behalf of the Company.

In their motion to dismiss for lack of standing, defendants requested that the court apply, by analogy, the "continuous ownership rule" found in corporate law, which requires a plaintiff stockholder suing derivatively on behalf of the corporation to own stock in the corporation throughout the litigation. The court stated that the "continuous ownership rule" is embodied in DGCL Section 327 and Court of Chancery Rule 23.1. Defendants argued that Section 18-1002 of the LLC Act includes similar requirements as those found in DGCL Section 327 and Court of Chancery Rule 23.1, making application of the "continuous ownership rule" appropriate in the LLC context and therefore necessitating dismissal. The court held that the "continuous ownership rule" applied in this case and that, because plaintiff no longer held any interests in the Company and no exception to the "continuous ownership rule" had been established by plaintiff, defendants' motion to dismiss for lack of standing was granted and no final judgment was issued.

12. *Dirienzo v. Lichtenstein*, C.A. No. 7094-VCP (Del. Ch. Sept. 30, 2013) (V.C. Parsons)

This case involved a series of transactions in which a hedge fund formed as a Delaware limited partnership merged with a publicly traded portfolio company that was a Delaware corporation with a minority interest held by the public, which was converted in connection with such merger to a publicly traded limited partnership (the "Partnership"). Plaintiff was a minority shareholder of the portfolio company and brought claims based on both pre-merger actions by the board of the portfolio company and others and post-merger actions by the general partner of the Partnership (the "General Partner"), the managing member of the General Partner and the directors of the General Partner. With respect to the claims involving conduct after the merger, plaintiff's main allegations were (i) direct claims against a special committee of the portfolio company, arguing that they functioned as the board of the General Partner post-merger and breached their fiduciary duties in taking certain actions related to the merger, (ii) derivative claims against the General Partner, its managing member and the board of the General Partner for alleged breaches of fiduciary and contractual duties by having the Partnership assume a deferred fee liability that was owed by an affiliate of the hedge fund pre-merger, granting investors in the hedge fund that desired to exit their investment units in the Partnership in addition to cash and distributions in-kind of portfolio securities (the "Partial Unwind") and allowing the managing member of the General Partner to purchase "corporate opportunity units" in the Partnership and (iii) derivate claims against the General Partner for alleged breaches of its express and implied contractual duties under the partnership agreement of the Partnership by disposing of substantially all of the Partnership's assets in connection with the Partial Unwind and acting without a board in place for a certain period of time. The court granted the special committee's motion for dismissal for failing to state a direct claim upon which relief could be granted. The court also granted defendants' motion to dismiss the derivative claims for failure to make a demand.

With respect to the direct claims against the special committee, plaintiff alleged that the special committee impermissibly took actions for which they should be held liable at a

time when the General Partner did not constitute a board of directors. Plaintiff claimed the special committee served as the General Partner's de facto board during this time. The court disagreed, ruling that because the special committee had said only that it would "not refuse to grant consent" to proposed actions, it had neither actual nor de facto authority.

With respect to the derivative claims, the court first addressed whether demand was futile. Plaintiff argued that demand was futile because, in the limited partnership context, whether demand would be futile should only be considered from the perspective of the general partner. The court noted that although there is Delaware case authority supporting this position where limited partners had no say in how a general partner was governed, in the instant case, the partnership agreement provided that the limited partners had the right to elect directors of the General Partner. The court held that because the limited partners elected the board of the General Partner and because the members of the board owed fiduciary duties to the limited partners, demand should have been directed to the board of the General Partner and not the General Partner itself. Plaintiff also argued that the exculpatory provisions in the partnership agreement were unenforceable and therefore the board of the General Partner was therefore threatened with liability, rending demand futile. The court noted that where directors are exculpated contractually or otherwise from liability for certain conduct, such as in a partnership agreement, then a serious threat of liability may only be found to exist if the plaintiff pleads a non-exculpated claim against the directors based on particularized facts. Thus, whether a partnership agreement is enforceable is important to a determination of whether demand is excused. The court found the exculpatory provisions in the partnership agreement to be enforceable because the merger was validly consummated in accordance with the DGCL and organizational documents of the portfolio company to which the plaintiff was bound by becoming a stockholder thereof. Plaintiff then argued that the exculpation provisions in the partnership agreement were ambiguous and failed to eliminate fiduciary duties. The partnership agreement provided in relevant part that, except as otherwise provided in the partnership agreement, each director shall have the same fiduciary duties as a director of a corporation incorporated under the DGCL. However, the partnership agreement also provided that, notwithstanding anything to the contrary set forth therein, no general partner, board member thereof or other indemnitee would be liable except for bad faith, fraud, willful misconduct or gross negligence. Further, the partnership agreement expressly approved transactions contemplated by the merger and waived any conflicts of interest in connection therewith. The court found that these provisions were not ambiguous and that in cases in which the General Partner executed, delivered or performed any agreement authorized or permitted under the partnership agreement, the General Partner contractually eliminated its liability to limited partners to the greatest extent allowed by law. Because of this, the court dismissed several of plaintiff's claims involving breaches of the partnership agreement because demand was not made and the defendants were exculpated for the alleged actions under the terms of the partnership agreement. In addition, with respect to claims involving actions taken by the General Partner during the period of time in which there was no board of the General Partner, because any and all of such actions related to the merger, the court found that demand was also required for those claims. In its analysis as to whether demand was excused, the court last addressed whether a majority of the board members were independent. The

court found that each director that met the NYSE test for independence also satisfied the Delaware test for independence. In this finding, the court noted that although a director that qualifies for independence under the NYSE rules does not necessarily mean they are independent as a matter of Delaware law, the NYSE rules are a "useful source" for this determination. Accordingly, the court found that demand was not excused with respect to the derivative claims.

The plaintiff also apparently argued in briefing and at argument that these derivative claims were both direct and derivative under *Tri-Star* and *Gentile*, which required a showing, applying corporate law by analogy, that (i) a stockholder had majority or effective control and caused the corporation to issue "excessive" shares of its stock in exchange for assets of the controlling stockholder that have a lesser value and (ii) the exchange caused an increase in the percentage of the outstanding shares owned by the controlling stockholder, and a corresponding decrease in the share percentage owned by the public (minority) shareholders. Based on the facts in this case, the court found that plaintiff failed to satisfy both of these prongs with respect to each of the claims—assumption of deferred liability fee and purchase by the managing member of the General Partner of corporate opportunity units. The court accordingly treated the claims as derivative, stating that because the plaintiff had failed to make a demand upon the General Partners' board, the court would dismiss unless demand could be excused as being futile.

The court next considered whether demand was excused with respect to claims involving the deferred liability fee. The court noted that the *Rales* test applied where (i) a business decision was made by the board of a company but a majority of the directors making the decision was replaced, (ii) where the subject of the derivative suit was not a business decision of the board and (iii) where the decision being challenged was made by the board of a different corporation. In this case, the board applied the *Rales* test to determine whether demand was futile with respect to the claim involving the assumption by the Partnership of the deferred fee liability. Under the *Rales* test, demand is excused only where particularized factual allegations create a reasonable doubt that, as of the time the complaint was filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand. A board exercises its independent and disinterested business judgment when it responds to a demand free of personal financial interest and improper extraneous influences, which include domination by a controlling shareholder and a substantial risk of personal liability. The court found that demand was not excused as plaintiff failed to demonstrate this.

The court then addressed whether demand was excused with respect to a separate claim relating to payment of the deferred liability fee. Because *Rales* did not apply to this question, the court applied the *Aronson* test. To succeed under this test, the court noted that plaintiff must plead particularized facts that create a reasonable doubt that (i) the directors are disinterested and independent or (ii) the challenged transaction was otherwise the product of a valid exercise of business judgment. With respect to the first prong, which the court noted was virtually identical to the *Rales* test, the court indicated that, to succeed, the plaintiff must have alleged that the board of the General Partner

faced a substantial likelihood of personal liability for their decision to change the deferred fee agreement. The court looked to the partnership agreement, which limited liability to, in relevant part for this case, gross negligence, bad faith and willful misconduct. The court found that gross negligence requires pleading and proving that a defendant was recklessly uninformed or acted outside the bounds of reason. The court found that the deferred liability fee agreement had certain benefits to the Partnership and was therefore, among other reasons, not outside the bounds of reason. With respect to bad faith and willful misconduct, the court noted that a fiduciary's conduct is in bad faith if the fiduciary acted with a purpose other than advancing shareholder interests (i.e. the best interests of the corporation), intentionally violated relevant positive law, intentionally failed to respond to a known duty, or exhibited a conscious disregard of a known duty. In this regard, the court noted that to overcome the presumption that a fiduciary acted in good faith and state a claim for bad faith, a plaintiff must show that the fiduciary's actions were so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith. The court noted that even if this were a bad business decision, it was approved by independent directors that had a reasonable basis for their decisions and thus the plaintiff did not demonstrate bad faith. Turning to the second prong of *Aronson*, the court noted that this would also require a showing of bad faith or gross negligence. For the above reasons, plaintiff did not satisfy this "heavy burden." The court applied the same analysis under the *Aronson* test for the claim relating to the corporate opportunity units and similarly found that plaintiff's claim was deficient.

Finally, the plaintiff alleged that certain underlying offenses articulated in its complaint breached the covenants of good faith and fair dealing. Because, pursuant to *Gerber v. Enterprise Products Holding, LLC*, only parties to a contract may breach these covenants, the court held that only the General Partner could be liable and not the members of its board. Therefore, the plaintiff was required to demonstrate that the General Partner had breached the covenants and that the General Partner's board had facilitated such breach to show that demand was excused. Because the court found that the board of the General Partner did not act in bad faith or with gross negligence, the court held that demand was not excused. The court then dismissed the last claim of aiding and abetting because all underlying claims had been dismissed.

13. *Fla. R&D Fund Investors, LLC v. Fla. BOCA/Deerfield R&D Investors, LLC*, C.A. No. 8400-VCN (Aug. 30, 2013) (V.C. Noble)

Plaintiff, a member of a joint venture formed as a Delaware LLC (the "Joint Venture"), brought a books and records action under Section 18-305 of the LLC Act and the Joint Venture's LLC Agreement seeking certain information for the purposes of appointing a new asset manager and investigating possible mismanagement of the Joint Venture due to certain alleged improper payments to the Joint Venture's former asset manager (the "Asset Manager"). Plaintiff named the Joint Venture, the Asset Manager, the other members of the Joint Venture and certain other affiliated parties as defendants. Defendants, other than the Joint Venture, moved to dismiss for lack of personal jurisdiction and failure to state a claim upon which relief can be granted.

Plaintiff alleged the court had personal jurisdiction over the Asset Manager, an Indiana corporation with an Indiana address, pursuant to the Delaware long-arm statute or LLC Act Section 18-109. The court declined to exercise jurisdiction over the Asset Manager under the Delaware long-arm statute, noting that merely participating in the management of a Delaware entity – with no allegation of extensive and continuing contacts with Delaware – does not subject a party to the court's long-arm jurisdiction. The court stated that plaintiff failed to allege that the Asset Manager took any actions inside the State of Delaware with respect to the Joint Venture or that the Asset Manager was involved in the formation of the Joint Venture.

The court next addressed whether the Asset Manager was subject to the court's jurisdiction under Section 18-109, which provides that service as a manager of an LLC constitutes implied consent to the court's jurisdiction. For purpose of Section 18-109, the term "manager" refers "(i) to a person who is a manager as defined in [LLC Act Section 18-101(10)] and (ii) to a person, whether or not a member of a limited liability company, who, although not a manager as defined in [LLC Act Section 18-101(10)], participates materially in the management of the limited liability company; provided however, that the power to elect or otherwise select or to participate in the election or selection of a person to be a manager as defined in [LLC Act Section 18-101(10)] shall not, by itself, constitute participation in the management of the limited liability company." Because the Joint Venture's LLC Agreement explicitly provided that the Board of Directors of the Joint Venture was the manager of the Joint Venture for purposes of the LLC Act and the LLC Agreement did not name or designate the Asset Manager as a manager of the Joint Venture, the court held that the Asset Manager was not a manager of the Joint Venture for purposes of the first prong of Section 18-109.

The court then examined whether the Asset Manager had participated materially in the management of the Joint Venture so as to make it a manager of the Joint Venture for purposes of the second prong of Section 18-109. Under the Asset Manager's asset management agreement with the Joint Venture, the Asset Manager was identified as an independent contractor and was confined to acting as the asset manager and providing certain enumerated services in a manner consistent with the Joint Venture's business plan and budget. The court did not determine whether this level of authority was sufficient to constitute material participation in the manager of the Joint Venture because the court found that plaintiff had not alleged that the Asset Manager actually engaged in any of its contractually authorized conduct. The court stated that merely having the capacity to participate in management does not constitute material participation in management and thus dismissed plaintiff's claim against the Asset Manager for lack of personal jurisdiction.

The court then turned to plaintiff's claim against defendants other than the Joint Venture and the Asset Manager seeking a right to inspect records allegedly held by such defendants, which defendants were other members of the Joint Venture and affiliates of such members. The court granted defendants' motion to dismiss, holding that the complaint did not state a claim against those defendants because plaintiff failed to identify any contractual or statutory basis that would provide it with a right to inspect the books and records of members or parties affiliated with such members.

14. *Stewart v. BF Bolthouse Holdco, LLC*, C.A. No. 8119-VCP (Del. Ch. Aug. 30, 2013) (V.C. Parsons)

Plaintiffs, former employees of the defendant LLC (the "Company"), brought claims against the Company and its board of managers (the "Board") for breach of contract, breach of fiduciary duty and breach of the implied covenant of good faith and fair dealing in connection the Company's repurchase of plaintiffs' membership units in the Company (the "Units"). Plaintiffs' acquired their Units by executing the LLC agreement of the Company (the "LLC Agreement") and a purchase agreement (the "Purchase Agreement"). Upon plaintiffs' voluntary termination of their employment with the Company, the Company exercised its right under the Purchase Agreement to repurchase plaintiff's vested and unvested Units. The Board determined the Fair Market Value (as defined in the Purchase Agreement) of plaintiffs' Units under the Purchase Agreement was $0.00 and cancelled the Units without paying any consideration.

The court granted defendants' motion to dismiss plaintiffs' claims of breach of fiduciary duties and breach of the implied covenant of good faith and fair dealing, and denied in part and granted in part the motion with respect to the breach of contract claim. In light of an e-mail from the president and CEO of the Company valuing the Units at $200 each three weeks after the Board determined the Fair Market Value was $0.00, the court held that it was reasonably conceivable that the Fair Market Value of the Units was greater than $0.00 and that the Board acted in bad faith in determining the value in breach of the Purchase Agreement. The court also noted that defendants did not argue that any material event occurred during those three weeks that affected the valuation. The court further held that plaintiffs sufficiently pled facts that defendants' valuation of $0.00 was determined in bad faith because of facts indicating a value of the Units greater than $0.00 in surrounding years, and because the valuation was done at a time when defendants were no longer obligated to provide plaintiffs with relevant financial information of the Company. Moreover, plaintiffs pled a plausible motivation—to increase the majority owner's interest in the Company or, alternatively, as retribution for plaintiffs' unexpected departure from the Company at a time when plaintiffs were important to the future success of the Company. The court noted that although a claim of wrongful inducement, trickery or deception may be sufficient to establish bad faith, those elements are not necessary under Delaware law. The court therefore denied defendants' motion to dismiss plaintiffs' breach of contract claim that the Board determined the Fair Market Value of the Units in bad faith.

The court held that the LLC Agreement's fiduciary duty provision—which provided that the managers owed the same fiduciary duties as a director of a corporation—applied to the Board's determination of the value of the Units because execution of the LLC Agreement by plaintiffs was a condition precedent to receipt of their Units under the Purchase Agreement, and the duties to act carefully and loyally were not inconsistent with or contradictory to the Purchase Agreement's requirement that the Board determine the Fair Market Value of the Units in good faith. However, because plaintiffs made no allegations regarding the Board's valuation process, the court held that plaintiffs failed to state a claim for breach of the contractual duty of care. Plaintiffs also failed to state a claim of breach of the duty of loyalty on the basis that the repurchase was an interested

transaction because plaintiffs did not allege that defendants stood on both sides of the repurchase transaction, nor did they allege that defendants were in a position to benefit from an unfairly low repurchase in a manner not shared equally with all owners of the Company. However, for the same reasons the contractual bad faith claim under the Purchase Agreement survived, the court held that plaintiffs sufficiently alleged that defendants acted in bad faith in determining the Fair Market Value in breach of the contractual duty of loyalty under the LLC Agreement. The court therefore denied defendants' motion to dismiss this claim.

The court dismissed plaintiffs' claim that defendants breached the LLC Agreement's requirement that the Company deliver to the members annual financial statements because the LLC Agreement only required the Company to provide the financial statements to a person with a present ownership interest in the Company, and plaintiffs no longer had a present ownership interest in the Company at the time the annual financial statements were required to be provided. The court also dismissed plaintiffs' claim that defendants breached the Purchase Agreement by "cancelling" the Units rather than "repurchasing" them as provided in the Purchase Agreement, holding that the only issue was whether the Company properly exercised the repurchase right, and so that claim was duplicative of plaintiffs' breach of contract claim.

The court similarly dismissed plaintiffs' breach of fiduciary duty claim because it was duplicative of and foreclosed by the breach of contract claim. Under Delaware law, a fiduciary duty claim that depends on the same nucleus of operative facts as a breach of contract claim only survives where it may be maintained independently of the breach of contract claim. Plaintiffs' fiduciary duty claim—that defendants acted contrary to their fiduciary duties to plaintiffs when they purported to declare the Units held no value and cancelled them—arose from the dispute relating to the contractual repurchase right under the Purchase Agreement. The breach of fiduciary duty claim was not broader in scope, nor did it implicate potentially different remedies. Finally, the court dismissed plaintiffs' claim that defendants violated the implied covenant of good faith and fair dealing by failing to act in good faith when valuing the Units. Plaintiffs did not allege a specific implied contractual obligation that was breached, and the issue was covered by an express term in the Purchase Agreement requiring the Board to value the Units in good faith. Therefore, the court also held the claim was duplicative.

15. *Grove v. Brown*, C.A. No. 6793-VCG (Del. Ch. Aug. 8, 2013) (V.C. Glasscock)

This post-trial opinion involved a dispute between two members of one family (the "Plaintiffs") and two members of another family (the "Defendants") who formed a Delaware LLC ("Heartfelt") to engage in a home health care business. As the relationship between the Plaintiffs and the Defendants soured, the Defendants attempted to merge Heartfelt with an entity owned by them to freeze out the Plaintiffs, claiming that they had authority to do so because they owned a majority of the membership interests in Heartfelt. In that regard, the Defendants argued that the Heartfelt LLC agreement required each member to contribute $10,000 as an initial capital contribution and that the Plaintiffs failed to make their capital contribution in full and, based on the contributions provided to date, the Defendants owned a majority of the membership interests of

Heartfelt. In addressing this issue, the court focused on the provisions in the Heartfelt LLC agreement essentially providing that each member was required to contribute $10,000 and indicating that each member had a 25% membership interest in Heartfelt as well as the provisions providing that the profits and losses should be divided among the members "in proportion to each Member [sic] relative capital interest in [Heartfelt]." The court found that these provisions unambiguously provided that each member was a 25% equal owner and that nothing in the Heartfelt LLC agreement indicated that ownership was contingent on the obligation to provide the capital contribution. The court further noted that even if it were to consider extrinsic evidence, there were membership certificates reflecting a 25% membership interest of each member and certain conduct of the parties (e.g. representations to a potential lender of equal ownership) that were consistent with the court's interpretation of the Heartfelt LLC agreement. Although the Defendants argued that the membership certificates were invalid for failure to provide a date or the company seal, the court mentioned that it did not consider the certificates to be contracts but it did consider them to be overt statements demonstrating the understanding of the members of Heartfelt. The court held that the purported merger was a legal nullity as the Heartfelt LLC agreement did not address mergers and the Defendants did not have the authority to effectuate a merger because they did not own more than 50% of the then current percentage in the profits of Heartfelt as required under the LLC Act.

The court then turned to the Defendants' counterclaims that the Plaintiffs, as managing members of Heartfelt along with the Defendants, violated their fiduciary duties by taking corporate opportunities from Heartfelt. The Plaintiffs had formed a Maryland LLC which operated fewer than ten miles from the offices of Heartfelt and then formed a Delaware LLC with an office in the same building as Heartfelt, each engaged in the same business as Heartfelt. The court cited to *Feeley v. NHAOCG, LLC* for the principle that default fiduciary duties apply to managing members of an LLC. The court then referred to corporate case law by analogy, noting that the corporate opportunity doctrine is a consequence of a fiduciary's duty of loyalty and it exists to prevent officers or directors (or a managing member of an LLC) from personally benefiting from opportunities belonging to the corporation (or an LLC). The court further noted that under the doctrine a corporate officer or director (or managing member of an LLC) may not take a business opportunity as his own if: (1) the corporation is financially able to exploit the opportunity; (2) the opportunity is within the corporation's line of business; (3) the corporation has an interest or expectancy in the opportunity; and (4) by taking the opportunity for his own, the corporate fiduciary will thereby be placed in a position inimicable to his duties to the corporation; but, a director or officer may take personal advantage of a corporate opportunity if: (1) the opportunity is presented to the director or officer in his individual and not corporate capacity; (2) the opportunity is not essential to the corporation; (3) the corporation holds no interest or expectancy in the opportunity; and (4) the director or officer has not wrongfully employed the resources of the corporation in pursuing or exploiting the opportunity. The court highlighted that this is essentially a factual question and the burden is on the fiduciary to show that he or she did not seize a corporate opportunity. Based on the facts presented at trial, the court found that the Plaintiffs breached their duty of loyalty by usurping business opportunities of Heartfelt in forming two competing entities. The court focused on the evidence relating

to whether or not the Defendants disclaimed their right to pursue the corporate opportunity and found that the evidence demonstrated that, although the Defendants knew the Plaintiffs were interested in expanding, the Defendants had not clearly disclaimed their right to pursue expansion and in fact had plans to eventually cause Heartfelt to expand even if not as quickly as the Plaintiffs desired. The court also found that notwithstanding the fact that the Plaintiffs presented the opportunity to join the Defendants as members of the competing entities, presenting an opportunity to other members was not the same as presenting it to Heartfelt. The court determined that the appropriate remedy was for each party to account to Heartfelt for profits that they wrongfully kept for themselves as the Defendants attempted a merger that was not valid but presumably made profits thereafter and the Plaintiffs usurped corporate opportunities by forming the competing entities that also presumably made profits. The court also noted that although it would not effectuate a judicial dissolution sua sponte, it hoped that the parties would present a petition for dissolution because given the bitterness and acrimony between the parties, it was not reasonably practicable to carry on the business of Heartfelt in conformity with the Heartfelt LLC agreement.

Lastly, the court rejected counterclaims against certain of the Plaintiffs' relatives who worked for the competing entities for aiding and abetting because the Defendants failed to present evidence that the counterclaim defendants knowingly participated in breaches of fiduciary duty.

16. *Natural Energy Dev., Inc. v. Shakespeare-One Ltd. P'ship*, C.A. No. 4836-CS (Del. Ch. July 26, 2013) (Chancellor Strine)

Plaintiff was the managing general partner of Shakespeare-One L.P. ("Shakespeare One"). Under the terms of the Shakespeare One Partnership Agreement (the "Partnership Agreement"), plaintiff was entitled to a share of Shakespeare One's profits (the "GP Interest"). In 2009, the Shakespeare One limited partners purportedly removed plaintiff as Shakespeare One's general partner and refused to pay plaintiff the GP Interest. Subsequently, defendants conceded that plaintiff was never properly removed as the general partner of Shakespeare One.

Plaintiff sought summary judgment and (i) requested a declaratory judgment that it could not be deprived of the GP Interest without its consent, regardless of whether plaintiff remained Shakespeare One's general partner, (ii) sought a declaration that it was not Shakespeare One's general partner, and (iii) requested attorney's fees on the theory of bad faith action by defendants.

The court found that the matter was appropriately subject to review for a declaratory judgment and summary judgment. The court then held that the Partnership Agreement unambiguously vested the GP Interest in plaintiff irrevocably. Specifically, the Partnership Agreement stated that plaintiff "ha[d] received" the GP Interest for services it had provided to Shakespeare One. The court interpreted this provision to mean that plaintiff earned the GP Interest through plaintiff's actions in setting up Shakespeare One. Further, the Partnership Agreement provided that the rights of plaintiff in interests it held

as a partner continued even if plaintiff were removed as general partner. Therefore, the limited partners' attempt to divest plaintiff of the GP Interest was invalid.

The court declared that plaintiff was not the general partner of Shakespeare One, as another party had been the de facto general partner for over four years. However, the court denied plaintiff's request for attorneys' fees under its theory that defendants acted in bad faith because there were no "extraordinary circumstances" that warranted providing attorneys' fees to plaintiff under the bad faith exception to the American Rule.

17. *Allen v. Encore Energy Partners, L.P.*, C.A. No. 534, 2012 (Del. July 22, 2013) (*en banc*)

This was an appeal of the Court of Chancery's dismissal of a class action complaint 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 (collectively, the "Defendants") breached their duties under the partnership agreement by proposing, approving and consummating the Merger. The Delaware Supreme Court affirmed the Court of Chancery's decision.

In its analysis, the court first addressed what duties were owed by the Defendants. Like the Court of Chancery, the court found that the partnership agreement eliminated all fiduciary duties of the board members of the general partner and Vanguard except as expressly set forth in the partnership agreement. However, the partnership agreement did establish a contractual duty to act in good faith when the general partner or its affiliates made a determination or took an action. The court also referred to a provision in the partnership agreement requiring the general partner to consent before the Partnership could merge with another entity and concluded that when determining to consent to a merger, the general partners and its affiliates must act in accordance with this contractual duty of good faith. "Good faith" was defined as a "belie[f] that the determination or other action is in the best interests of the Partnership." However, the partnership agreement also provided a "safe harbor" for resolution of conflict transactions, which essentially provided that action taken by the general partner or its affiliates would not constitute a breach of the partnership agreement or of any duty if it received "Special Approval," which consisted of approval by a majority of the members of the Conflicts Committee acting in good faith. Further, if "Special Approval" were sought, the partnership agreement provided that "it shall be presumed that, in making its decision, the Conflicts Committee acted in good faith . . . [and] the Person bringing or prosecuting such proceeding shall have the burden of overcoming such presumption . . . ."

The court then turned to the question of whether the plaintiffs sufficiently pled that the Defendants breached their contractual duty of good faith. The court applied well-settled contract interpretation principles to give meaning to a contractual duty requiring a "belie[f] that the determination or other action is in the best interests of the Partnership."

According to *Black's Law Dictionary*, the court noted that "believe" means to "feel certain about the truth of; to accept as true." The court contrasted this with "reasonably believe" which was defined therein to mean to believe "under circumstances in which a reasonable person would believe." Because some partnership agreements use "believe" while others use "reasonably believe," the court discerned that the parties intentionally distinguished these two standards. Therefore, the court confirmed the Court of Chancery's decision in finding that this required subjective belief.

The court then addressed the Court of Chancery's holding that the plaintiff must have shown that the defendants subjectively believed that they were acting *against* the Partnership's interests to adequately plead a breach of the contractual duty to act in good faith. The plaintiff argued that, to the contrary, it is possible for a person to breach a subjective good faith standard without subjectively believing that his actions were *against* the best interests of the Partnership. The court essentially agreed with the plaintiff by finding that it is possible that a defendant may not subjectively believe that an action is in the partnership's best interests, but nonetheless does not subjectively believe that the action is against the partnership's best interests. The court noted that a person who "intentionally fails to act in the face of a known duty to act" neither subjectively believes his decision is in the best interests of the partnership nor subjectively believes he is affirmatively acting against the best interests of the partnership. However, the court continued, to fail intentionally to act in the face of a known duty, there must be a "duty" in the first place and the partnership agreement of the Partnership replaced common law fiduciary duties with a contractual duty of subjective good faith. Therefore, to plead a breach of the contractual duty of subjective good faith under the partnership agreement of the Partnership, the court indicated that the plaintiff had to plead facts that would enable a court reasonably to infer that the Conflicts Committee members did not subjectively believe that the Merger was in the Partnership's best interests, which could be accomplished by showing either that they believed they were acting *against* the Partnership's best interests when approving the Merger or that they consciously disregarded their duty to form a subjective belief that the merger was in the Partnership's best interests.

With regard to how a plaintiff could plead a defendant's state of mind, the court determined that the Chancery Court was not correct in finding that the objective reasonableness of the Conflicts Committee's determination was not relevant to a subjective standard. The court cited to prior case law in finding that some actions may objectively be so egregiously unreasonable that they seem essentially inexplicable on any ground other than subjective bad faith. The court highlighted that it may also be reasonable to infer subjective bad faith in less egregious transactions when a plaintiff alleges objective facts indicating that a transaction was not in the best interests of the partnership and that the directors knew of those facts. Although distinct from an objective "reasonable person" standard, the court found that objective factors may inform an analysis of a defendant's subjective belief to the extent they bear on the defendant's credibility when asserting that belief. In this case, the plaintiff merely alleged facts that showed that the Conflicts Committee members may have negotiated poorly and that the counteroffer made by the Conflicts Committee was below the median of the investment banker's analysis but his claims did not permit a reasonable inference that they

subjectively believed they were acting against the Partnership's best interests. The court also found that the complaint did not allege any facts from which the court could reasonably infer that the Conflicts Committee members consciously disregarded their contractual duty. In this regard, allegations that the Conflicts Committee should have made a higher counteroffer or negotiated better did not support a reasonable inference that they consciously disregarded a duty to form a subjective belief that the transaction was in the Partnership's best interests.

Finally, the court addressed the plaintiff's claim that obtaining Special Approval could not insulate Vanguard from liability for causing the general partner to depress the value of the units in the Partnership in anticipation of the merger. The court found that the plaintiff failed to state a claim against the defendants because plaintiff's complaint only stated a single claim relating to the merger—not that these other actions constituted independent breaches.

18. *Grosvenor Orlando Assocs. v. HCP Grosvenor Orlando LLC*, C.A. No. 7246-VCG (Del. Ch. June 26, 2013) (V.C. Glasscock)

In this motion for judgment on the pleadings, the court was asked to determine whether an LLC agreement required the payment of an annual asset management fee or, alternatively, provided a prospective waiver of a potential conflict of interest if an asset management fee was ultimately agreed to. The LLC agreement provided in one section that the "Operating Member hereby Approves the payment to Grosvenor Properties, Ltd. by the Company or Owner of an annual asset management fee in an amount equal to one percent (1.0%) of Gross Receipts, which . . . shall be payable monthly . . . ." In another section, the LLC agreement provided that the "Operating Member" could amend asset management and similar agreements without the consent of the other party to the LLC agreement "except . . . with respect to the payment of the asset management fee to Grosvenor Properties, Ltd." Plaintiffs argued that these sections required a payment of the asset management fee whereas defendants argued that they imposed no such obligation, but simply waived potential conflicts-of-interest because the parties contemplated that a separate agreement concerning management fees would be entered into in the future. The court applied well-settled Delaware contract interpretation principles and found that these provisions created an ambiguity and thus denied the motions for judgment on the pleadings.

19. *Gerber v. Enterprise Holdings, LLC*, C.A. No. 5989 (Del. June 10, 2013) (*en banc*)

This case involved the purchase in 2007 by Enterprise GP Holdings, L.P., a master limited partnership (the "Partnership"), of Texas Eastern Products Pipeline Company, LLC ("Teppco GP"), the general partner of Teppco Partners, LP ("Teppco LP"). In 2009, defendants caused the Partnership to sell Teppco GP to Enterprise Products Partners, L.P. ("Enterprise Products LP") (the "Transaction"), and then later on the same day caused the Partnership to sell Teppco LP to Enterprise Products LP in a separate transaction (the "Teppco LP Sale"). The consideration received by the Partnership for the 2009 Sale was only 9% of the Partnership's original purchase price. In 2010 the Partnership merged

with another limited liability company ("MergeCo") and no longer exists (the "2010 Merger").

Plaintiff, a former limited partner of the Partnership and current holder of interests in the parent of MergeCo, challenged the Transaction and the 2010 Merger on behalf of the Partnership as unfair to the Partnership, claiming the defendants breached fiduciary duties in approving the Transaction and the 2010 Merger. The limited partnership agreement of the Partnership (the "LPA") eliminated common law fiduciary duties of Enterprise Products Holdings, LLC, the general partner of the Partnership (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"). Further, a provision in the LPA created a "conclusive presumption" that the General Partner acted in "good faith" when acting or not acting in reliance upon an opinion of experts as to matters the General Partner reasonably believed were within the expert's professional or expert competence.

The Court of Chancery held that plaintiff failed to state a claim and granted defendants' motion to dismiss under Rule 12(b)(6). Plaintiff appealed and the Supreme Court of Delaware affirmed in part, reversed in part, and remanded.

The court held that the Court of Chancery erred in determining that the contractual "conclusive presumption" of good faith barred a claim under the implied covenant of good faith and fair dealing. The court adopted the Court of Chancery's reasoning in *ASB Allegiance Real Estate Fund v. Scion Breckenridge Management Member, LLC*, 50 A.3d 434 (Del. Ch. 2012), holding that the contractual duty of "good faith" looked to the parties as situated at the time of the wrong, while the implied covenant looks to the past and what the parties would have agreed to themselves if they had considered the issue at the time of contracting. Moreover, Section 17-1101(d) of DRULPA explicitly prohibits a provision in a partnership agreement that eliminates the implied covenant.

Because the conclusive presumption only applied to the contractual duty of good faith, and not the implied covenant, the court considered whether plaintiff pled sufficient facts that, if true, would establish the General Partner breached the implied covenant when approving the Transaction or the 2010 Merger. Although the Committee obtained a fairness opinion regarding the Transaction, the opinion did not address whether holders of the Partnership's limited partnership interests received fair consideration for their Teppco GP interest, but instead only addressed the total consideration paid in both the Transaction and the Teppco LP Sale. The court held that, had the parties addressed the issue when contracting, they would have agreed that a fairness opinion must address

whether the consideration received specifically for Teppco GP was fair in order for the conclusive presumption to apply to approval of the Transaction.

The General Partner received a fairness opinion for the 2010 Merger as well. However, the Vice Chancellor held that the Complaint pled that a principal purpose of the 2010 Merger was to terminate claims relating to the 2007 transaction and the Transaction, and the fairness opinion did not independently value these claims in assessing the fairness of the consideration. The court held that had the parties addressed the issue when contracting, they would have agreed that in order for the conclusive presumption to apply to approval of the 2010 Merger, a fairness opinion must address the value of derivative claims when terminating such claims was a principal purpose of the merger.

Although the conclusive presumption did not apply, if the General Partner satisfied the Special Approval process there would be no breach of the LPA. Because the Committee obtained a fairness opinion for the Transaction and for the 2010 Merger, the contractual duty of good faith was satisfied, but the implied covenant independently applied to the Special Approval process as well. The Court of Chancery held that the Complaint sufficiently alleged that the General Partner selected the Special Approval process for the Transaction in bad faith in breach of the implied covenant because plaintiff would not have agreed that the Committee could rely on a flawed fairness opinion to grant Special Approval. That holding stands as law because defendants did not cross-appeal from that determination. The court similarly held that the limited partnership interest holders would not have agreed to allow the General Partner to terminate their interest through a merger intended to eliminate valuable claims without considering the value of such claims. The court held that with respect to both the Transaction and the 2010 Merger, the Complaint stated a cognizable claim that the General Partner breached the implied covenant, and the Court of Chancery reversibly erred in dismissing the claims. The court remanded for the Court of Chancery to consider the secondary liability claims for tortious interference with contract rights and aiding and abetting the General Partner's breach of contract.

20. *Norton v. K-Sea Transportation Partners, L.P.,* C.A. No. 6301 (Del. May 28, 2013) (*en banc*)

In this decision of the Delaware Supreme Court pertaining to K-Sea Transportation Partners L.P.'s ("K-Sea") merger with Kirby Corporation ("Kirby"), the court addressed the Court of Chancery's grant of the defendants' motion to dismiss the plaintiffs' complaint, reviewing that decision de novo and affirming it.

At the core of the dispute, the plaintiffs alleged that K-Sea's general partner, K-Sea General Partner L.P. ("K-Sea GP"), received excessive consideration for certain incentive distribution rights that it held when K-Sea was purchased by Kirby (the "IDR Payment"), thereby breaching its fiduciary duties under the K-Sea limited partnership agreement (the "LPA"). The plaintiffs did not allege that K-Sea GP breached the implied covenant of good faith and fair dealing.

The court found that the LPA established contractual fiduciary duties regarding mergers that displaced traditional fiduciary duties. K-Sea GP was required to exercise its discretion in approving any proposed merger and could consider any factors it chose in exercising that discretion. Additionally, K-Sea GP was indemnified under the LPA if it acted in "good faith," which, under the LPA, meant that K-Sea GP had to reasonably believe that its actions were in the best interests of, or not inconsistent with, the best interests of K-Sea.

The LPA also provided a permissive "safe harbor" for transactions that included potential conflicts of interest, including a permissive special approval process using a conflicts committee (the "Conflicts Committee") and also indicated that, if K-Sea GP's resolution of a conflict of interest was fair and reasonable or deemed to be fair and reasonable, then the resolution of the conflict would not breach the LPA. Finally, the LPA provided a conclusive presumption that K-Sea GP acted in good faith if it relied on a competent expert's opinion.

The court addressed whether the plaintiffs' complaint established a breach of the LPA's "good faith" standard, stating that it would not need to address whether a grant of phantom units to the members of the Conflicts Committee invalidated the permissive special approval process if the plaintiffs could not establish a breach of the good faith standard. The court found that the Conflicts Committee obtained an expert's opinion that stated that the consideration paid by Kirby to K-Sea's common unitholders was financially fair. No party challenged the expert's competence. Under the terms of the LPA, the expert was not required to address Kirby's IDR Payment to K-Sea GP separately from whether the overall merger was fair to K-Sea as a whole. The court found that the expert's opinion indirectly addressed the fairness of the IDR Payment by opining that the overall merger consideration paid was financially fair. K-Sea GP relied on that fairness opinion. Therefore, the court found that K-Sea GP was conclusively presumed to have acted in good faith when it approved the merger and sent it to the unitholders for a vote and affirmed the Court of Chancery's grant of the defendant's motion to dismiss.

21. *Senior Hous. Capital, LLC v. SHP Senior Hous. Fund, LLC*, C.A. No. 4586-CS (Del. Ch. May 13, 2013) (Chancellor Strine)

This post-trial opinion involved a fund (the "Fund") formed as a Delaware LLC to invest in retirement homes. Two of the plaintiffs, the former manager of the Fund (the "Manager") and its affiliate, held a 5% ownership interest in the Fund and the main defendant, the California Public Employee's Retirement System ("CalPERS"), held the remaining 95% ownership interest in the Fund. The plaintiffs sued CalPERS claiming that CalPERS was required to pay them under the LLC agreement of the Fund (i) an incentive distribution, (ii) the value of their membership interests upon their withdrawal as members of the Fund and (iii) certain asset management fees. CalPERS had not made these payments because it challenged appraisals that were performed to value assets of the Fund that were used as part of the calculation of each of these payments and essentially asked the court to perform its own appraisal.

The court first addressed the threshold issue of what judicial standard of review is appropriate when a party seeks to dispute a value determined by a contractually designated appraiser. The court noted that the provisions of the LLC agreement governing the appraisal process were based on form contracts CalPERS used with various investment managers and gave them unilateral authority over the process, including the selection of the appraisers. The Manager argued that the appraisal process was governed by the LLC agreement and that the court had no ability at all to review the appraisals for any reason. CalPERS, on the other hand, argued that the court must independently review the appraisals because there was no dispute resolution process in the appraisal process. The LLC agreement did not provide a dispute resolution mechanism for appraisals unless they were made at the end of a specified period. In highlighting that Delaware respects the freedom of contract, the court held that a court may not second-guess appraised values that have been committed by contract to determination by appraisers unless the contractual appraisal process has been tainted by a breach of the implied covenant of good faith and fair dealing (e.g., concerted bad faith action between the appraiser and the other party). The court observed that parties could agree in their LLC agreement to provide for whatever level of judicial review they desire, but the parties in this case did not provide for any such judicial review.

The court then addressed whether there was a breach by the Manager of the implied covenant in connection with the appraisal process. In this regard, CalPERS claimed that the Manager misled an appraiser by giving the appraiser bullish projections of the assets of the Fund's future performance. However, the court found that the evidence indicated that the appraiser made its own independent projections and, therefore, there was no breach of the implied covenant.

The incentive distribution was based on "distributions" made to CalPERS and CalPERS argued that the calculation of "distributions" was incorrect because the Manager included distributions in its calculation but had failed to transfer cash to CalPERS in accordance with the LLC agreement. A "distribution" was defined in the LLC agreement to mean any "cash payment . . . distributed by the Company to [a] Member . . . ." The LLC agreement also provided that cash would be swept into a bank account daily and that on a monthly basis the Manager would instruct the bank to remit to CalPERS its respective portion of cash. However, the LLC agreement also provided in the same section that the Manager was to manage cash in accordance with cash management policies established by CalPERS and these policies defined distributions as "deposits made by the partners into the collection account for ordinary income." The court found that this created an ambiguity in how distributions were to be made and looked to the parties' course of dealing as evidence of how the parties intended the contract to be interpreted. The court found that the parties, through their course of performance of the contract, understood that distributions could be made to CalPERS through the cash management system (i.e. by being swept into the collection account and not when distributed out of that account). For example, the court mentioned that the Manager made clear in its quarterly management reports that it was accounting for payments of cash to CalPERS through the cash management system as "distributions" and contained a specific line item for the incentive distribution and CalPERS never objected.

With respect to payment to the Manager and its affiliate for their membership interests, the LLC agreement required CalPERS to purchase their membership interests when they withdrew from the Fund. Under the LLC agreement, for purposes of valuing the membership interests, CalPERS was required to have the assets of the Fund appraised 120 days after the Manager gave notice of its intent to resign. CalPERS had an appraisal done on the 120th day. The court found as a factual matter that a representative of CalPERS spoke with the appraiser and persuaded them to reduce the value of the assets by increasing the discount rate and by taking into account a "hypothetical condition." The court found that the pressure that CalPERS applied was a violation of the implied covenant of good faith and fair dealing. The parties also disagreed on the date on which the payment for the membership interests would be calculated. The LLC agreement provided that upon a withdrawal, the date of "valuation" would be 120 days after the date of receipt of an intent to withdrawal. CalPERS argued that this referred only to the appraisal, which was only a part of the total calculation. The court found that the term "valuation" was used broadly to cover the entire value of the interest and that if the parties desired that this only refer to the appraisal, they could have stated this in the LLC agreement.

With regard to asset management fees, CalPERS claimed that the Manager erroneously included leasehold interests in its calculation of these fees. The court noted that the LLC agreement was silent on whether leasehold interests would be included. Therefore, the court looked to extrinsic evidence to determine the parties' intent and noted that the best extrinsic evidence was what the parties actually did. For five years, the asset management fee included the leasehold interest and CalPERS approved these fees during that period. Thus, the court indicated that it would not deviate from this established course of dealing between the parties.

Finally, the court addressed certain fiduciary claims asserted by the Manager but quickly ruled against the Manager because, citing to Delaware Supreme Court precedent, such claims arose out of the same facts as the alleged breach of contract claims and where a dispute arises from obligations that are expressly addressed by contract, that dispute will be treated as a breach of contract claim and any fiduciary claims arising out of the same facts that underlie the contract obligations are foreclosed as superfluous.

22. *Imbert v. LCM Interest Holding LLC*, C.A. No. 7845-ML (Del. Ch. May 7, 2013) (Master Legrow)

Plaintiff was a member and former manager of defendant LLCs and sought advancement of fees and expenses he incurred to defend a lawsuit filed against him after he was terminated from his position as manager of each defendant LLC. The LLC agreement of each defendant LLC required funds to be distributed to the members thereof to pay the income taxes of such members. Defendant LLCs claimed that plaintiff had been inflating his tax liability so that he would receive disproportionately large amounts of these distributions. Defendant LLCs filed suit against plaintiff in New York specifically alleging (i) that plaintiff owed fiduciary duties as a manager and had breached those duties by approving the allegedly improper distributions, (ii) that plaintiff was unjustly enriched by retaining the allegedly improper distributions, (iii) that plaintiff committed

fraud in approving the allegedly improper distributions, and (iv) that plaintiff wrongfully used a business expense account for personal travel and entertainment expenses.

The relevant provisions in the LLC agreement of each defendant LLC provided that such LLC shall indemnify any person "made, or threatened to be made, a party to any action or proceeding . . . by reason of the fact that he . . ., whether before or after adoption of this Article (a) is or was a Manager, or an officer of the Company . . . ." and such LLC shall advance or promptly reimburse "[a]ll expenses reasonably incurred by an Indemnified Person in connection with a threatened or actual action or proceeding with respect to which such Person is or may be entitled to indemnification . . . ." The court noted that summary judgment is an efficient and appropriate method to decide an advancement dispute because the relevant question turns on the application of the terms of the corporate instruments setting forth the purported right to advancement.

The court first highlighted that advancement and indemnification were mandatory under the LLC agreements of defendants LLCs and therefore the burden rested with the LLC defendants to prove that advancement was not required. Defendant LLCs claimed that plaintiff was not entitled to advancement because the New York proceedings involved plaintiff as a member and not as a manager. In citing to Delaware case law, the court indicated that "if there is a nexus or causal connection between any of the underlying proceedings . . . and one's official capacity, those proceedings are 'by reason of the fact' that one was a corporate officer." The court further stated that the nexus is established if the "corporate powers were used or necessary for the commission of the alleged misconduct." The court found that each of defendant LLCs' claims against plaintiff related to plaintiff acting in his capacity as a manager and not as a member and, therefore, such nexus was sufficiently established except in the case of the unjust enrichment claim. With regard to the unjust enrichment claim, defendant LLCs claimed plaintiff retained, as a member, the allegedly improper distributions. The court agreed and found that this claim did not arise by 'reason of the fact' that plaintiff was a manager of defendant LLCs.

Defendant LLCs also sought a declaratory judgment in the New York action that plaintiff was not a member of defendant LLCs. Because this determination would be based on whether plaintiff was properly removed as a manager (only a non-manager member could be expelled from the defendant LLCs), the court found that plaintiff was also entitled to advancement for the declaratory judgment action. In addition, the parties disputed plaintiff's request for advancement for fees he incurred in a books and records request. Although defendant LLCs claimed plaintiff had this right by virtue of being a member, the court found that this was not dispositive because he sought the books and records to defend claims asserted against him as a manager, which the court indicated was a legitimate part of 'defending' a suit. Thus, the court granted advancement for the books and records request. Finally, the court granted plaintiff an award of "fees on fees" and prejudgment interest to the extent the court granted plaintiff's contractual right to advancement.

23. *Poppiti v. Conaty*, C.A. No. 6920-VCG (Del. Ch. May 1, 2013) (V.C. Glasscock)

In this letter opinion, the court addressed a dispute as to whether a liquidating trustee of a law firm organized as an LLC (the "Firm") had authority to receive and distribute certain legal fees distributed after the dissolution of the Firm and to distribute those fees 50/50 between the two members of the Firm.

The court granted a motion for partial summary judgment regarding whether the liquidating trustee had the authority under the liquidation agreement to receive and distribute the fees because the party disputing the trustee's authority conceded the issue in his brief.

As to the decision to distribute the fees 50/50 to the two Firm members, the court noted that the liquidation agreement specified that the Firm should be wound up and the assets distributed according to Section 18-804 of the LLC Act. As applied, Section 18-804 provided that, after firm creditors were paid and capital contributions reimbursed, the assets should be distributed to the members in the proportion in which the members shared an interest in the firm. The Firm operating agreement provided that the two members shared the Firm's profits 50/50. Further, the members were not creditors by virtue of their post-dissolution efforts. Therefore, the court instructed the liquidating trustee to distribute the residual assets to the Firm's members in proportion to their membership interests.

24. *Li v. Standard Fiber, LLC*, C.A. No. 8191-VCN (Del. Ch. Mar. 28, 2013) (V.C. Noble)

Plaintiff Li sought advancement of legal fees pursuant to an indemnification agreement between Li and defendant Standard Fiber, LLC ("Standard Fiber"). Standard Fiber moved to stay the action in favor of arbitration, which the court granted.

Li was the founder of Standard Fiber's predecessor and became the 25% owner of Standard Fiber when he sold all the assets of the predecessor company to Standard Fiber for cash and a 25% interest pursuant to an asset purchase agreement, which contained a broad arbitration provision and an integration clause. The Standard Fiber LLC Agreement contained a mandatory arbitration provision and an integration clause, as did Li's employment agreement. The indemnification provision under which Li sought his legal fees contained an integration clause; it did not include an arbitration clause, but provided that if Standard Fiber contested Li's right to indemnification "the question of [Li's] right to indemnification shall be for an arbitrator or the court to decide."

Standard Fiber's controlling shareholders initiated an arbitration proceeding against Li in August 2012, claiming Li breached his fiduciary duties to the company. Li's counsel made a demand for advancement and indemnification in connection with that action and the parties executed an affirmation and undertaking, but no formal deal was reached. Li then filed a complaint in January 2013, submitting invoiced for all fees in connection with the August 2012 proceeding. Standard Fiber sought to dismiss the complaint because it alleged that a mandatory arbitration provision applies.

The court applied the standard established in *Willie Gary LLC v. James & Jackson LLC*, C.A. No. 1781 (Del. Ch. Jan. 10, 2006) (Del. March 14, 2006), which parallels federal law and presumes that the question of arbitrability is one for the court to decide, not arbitrators, unless there is "clear and unmistakable" evidence that the parties agreed to arbitrate. *Willie Gary* held that such evidence was present if the arbitration clause either generally provided for arbitration of all disputes or incorporated a set of arbitration rules that empowered arbitrators to decide arbitrability. Under *Julian v. Julian*, 2009 WL 2937121 (Del. Ch. Sept. 9, 2009), another element was added to the *Willie Gary* test providing that, even if the *Willie Gary* test were technically satisfied, the court must still "make a preliminary evaluation of whether the party seeking to avoid arbitration of arbitrability has made a clear showing that its adversary has made essentially no non-frivolous argument about substantive arbitrability." Turning to the facts of the case, the court held that the LLC Agreement and the asset purchase agreement provided generally for arbitration of all disputes, satisfying the first prong of *Willie Gary* and referenced the rules of Judicial Arbitration and Mediation Services, satisfying the second prong of *Willie Gary*. Because Standard Fiber had a colorable argument that Li's claims for indemnification and advancement touched upon those prior agreements, the court found that Li could not make the required showing under *Julian*. Therefore, the court granted Standard Fibers request to stay the action pending an arbitrator's determination of arbitrability.

25. *Wiggs v. Summit Midstream Partners, LLC*, C.A. No. 7801-VCN (Del. Ch. Mar. 28, 2013) (V.C. Noble)

Plaintiffs were former employees of defendant LLCs and were terminated without cause. In exchange for plaintiffs' management services, they received Class B membership interests in defendant DFW Midstream Management, LLC ("Management"), which was a member of defendant DFW Midstream Services, LLC ("Services"), thus providing plaintiffs with an indirect right to share in the profits of Services under certain circumstances. Plaintiffs had no management or business decision-making authority. Services was governed by a board of managers composed of four managers, three appointed by defendant Summit Midstream Partners, LLC ("Summit") and one appointed by Texas Competitive Electric Holdings Company, LLC ("TCEH"). Summit also served as the sole managing member of Management.

In 2011, Summit purchased all of TCEH's membership interest in Services. Defendants entered into a Second Amended and Restated Limited Liability Company Agreement of Services (the "2011 Amendment"), and Summit transferred its membership in Services to a newly created entity, Summit Midstream Holdings, LLC ("Summit Holdings"). Plaintiffs brought several claims in connection with the 2011 Amendment. The court granted defendant's motion to dismiss pursuant to Court of Chancery Rule 12(b)(6) with respect to each of plaintiffs' claims.

The court first rejected defendant's argument that plaintiffs lacked standing because they were not members of Services, and addressed each claim on its merits. Plaintiffs sought a declaratory judgment that the 2011 Amendment was invalid and a breach of the original Services LLC agreement (the "Original Services Agreement"), and that the 2011

Amendment was a breach of the implied covenant of good faith and fair dealing. The court found that plaintiffs proffered a reasonable inference that they have a "claim of right or other legal interest," as required by the Declaratory Judgment Act, because the Award Agreements setting forth the compensation structure for plaintiffs' services were listed as "Operative Agreements" incorporated by reference under Management's LLC agreement, and Management's LLC agreement was listed as an "Operative Agreement" incorporated by reference under the Original Services Agreement.

Plaintiffs' first challenge, that defendants breached the Original Services Agreement by amending such agreement in a way that materially affected plaintiffs' interests without their consent, failed. The Original Services Agreement provided that no amendment, modification or supplement thereto could adversely affect the interest of a member without such member's consent. Because plaintiffs were never members of Services, the court held that plaintiffs did plead a reasonably conceivable claim of breach of contract.

Plaintiffs similarly did not sufficiently plead rights under an implied covenant of good faith and fair dealing. Although the elimination of language regarding the duty of good faith and fair dealing from the Original Services Agreement has no legal effect because Delaware law prohibits LLCs from eliminating such duty, a plaintiff must allege a specific implied contractual obligation and how the violation of that obligation denied the plaintiff of the benefits of the contract. The court rejected plaintiffs' argument that defendants needed plaintiffs' consent in order to amend the Original Services Agreement in a way that essentially eliminated future payment for plaintiffs because the Original Services Agreement expressly set forth an amendment process and, therefore, an implied covenant was not appropriate. Plaintiffs' alternative formulation of the implied covenant—that the purpose of the parties' bargain was that plaintiffs, in exchange for their continued services, would receive a share of the profits after defendants received their return of capital—also failed. Summit provided the vast majority of the capital and, by taking only an indirect interest in profits, plaintiffs implicitly acknowledged that they did not acquire any corporate governance authority over Services. The court held that plaintiffs did not sufficiently allege any rights under an implied covenant of good faith and fair dealing.

The court rejected plaintiffs' claim that Summit and Summit Holdings breached their fiduciary duties under the Original Services Agreement because plaintiffs were not members of Services and therefore were not owed any fiduciary duties under the agreement, and because the agreement unambiguously eliminated fiduciary duties of the managers. Plaintiffs' claim for breach of fiduciary duties under Management's LLC agreement similarly failed because the agreement specifically eliminated any fiduciary duties of Summit. The court held that plaintiffs did not plead a reasonably conceivable claim that they were owed fiduciary duties.

Plaintiffs' claim that defendants committed fraud by failing to inform plaintiffs of the 2011 Amendment, and of the full scope and character of credit facilities and the resulting encumbrances on Services, failed. Plaintiffs based their fraud allegation on the theory that defendants either had a "duty to speak" or actively concealed information. Because plaintiffs were not members of Services and their consent to the 2011 Amendment was

not required, defendants did not have a duty to disclose the existence of the 2011 Amendment or the credit facilities to plaintiffs. Although one plaintiff sought a copy of the 2011 Amendment but was denied on the grounds that the 2011 Amendment prevented its disclosure, and another plaintiff asked whether there had been any amendments to the Original Services Agreement or Management's LLC agreement and was not answered, plaintiffs' lack of knowledge of the 2011 Amendment could not have been relied upon to their detriment because they could not challenge the adoption of such amendment. The court held that plaintiffs did not plead a reasonably conceivable claim of fraud.

Finally, plaintiffs sought an order dissolving Services and Management under Section 18-802 or Section 18-803 of the LLC Act. Because plaintiffs were not members or managers of Services, they could not apply for dissolution of Services under either provision. Looking to the analogous limited partnership dissolution statute, the court noted that the court orders dissolution is two situations: (1) where there is a "deadlock" that prevents the entity from operation and (2) where the defined purpose of the entity is fulfilled or impossible to carry out. With respect to Management, plaintiffs alleged the latter because plaintiffs disagreed with a credit facility entered into by defendants and the initial public offering of Summit Holdings. Because of Management's broad purpose clause allowing Management to engage in any lawful act or activity for which limited liability companies may be organized under the LLC Act, the court held that plaintiffs did not plead a reasonably conceivable claim for judicial dissolution.

26. *Meso Scale Diagnostics, LLC v. Roche Diagnostics GMBH*, C.A. No. 5589-VCP (Del. Ch. Mar. 8, 2013) (V.C. Parsons)

Plaintiffs, two Delaware LLCs with disputed springing rights to certain patented technology (the "ECL technology"), asserted that Defendants Meso Scale Diagnostics, LLC ("MSD") and Meso Scale Technologies LLC ("MST") breached their contractual duties because: (i) defendants' acquisition of certain intellectual property rights through a reverse triangular merger was an assignment by operation of law that required their consent, which defendants did not seek, and (ii) defendants made sales outside the licensed field of use in violation of the Roche License (defined below) Defendants moved for summary judgment, which the court granted as to the first assertion and denied as to the second.

Defendants in this case were Roche Holding Ltd. and its subsidiaries ("Roche"). In 1992, IGEN International, Inc. ("IGEN") granted a license to use the ECL technology to a company ultimately acquired by Roche (the "1992 License"). In 1995, IGEN and MST formed MSD and granted MSD a license to use IGEN's technology, which included the ECL technology ("MSD License"). In 1997, IGEN sued Roche for breach of contract and Roche was concerned that IGEN might terminate its 1992 License; in fact, IGEN sent Roche a notice purporting to terminate the 1992 License. Roche then purchased IGEN in 2003 and, as part of a restructuring in connection therewith (the "2003 Transaction"), (i) IGEN granted IGEN LS LLC, IGEN's wholly-owned subsidiary, a non-exclusive license to use the ECL technology (the "Roche License") and (ii) IGEN's intellectual property rights were spun off into a subsidiary that eventually became BioVeris Corporation ("BioVeris"). In connection with the 2003 Transaction, MSD and

MST signed a Global Consent preventing the assignment of rights of BioVeris "by operation of law or otherwise" without the prior written consent of the other parties. After the 2003 Transaction, BioVeris alleged that Roche was selling ECL-related products outside the field permitted by the Roche License. To acquire BioVeris's intellectual property rights, Roche acquired BioVeris in a reverse triangular merger in 2007. Plaintiffs then filed a complaint against Roche for breach of contract as to the Global Consent (Count I) and the Roche License (Count II). At issue in this decision is Plaintiffs' motion for summary judgment.

After determining that Count I was not barred by laches, the Court of Chancery determined that a reasonable interpretation of the Global Consent was that the rights, interests and obligations regarding BioVeris's intellectual property were subject to the consent provision of the Global Consent. Then the court addressed the issue of whether the reverse triangular merger whereby Roche acquired BioVeris was an assignment "by operation of law" that would trigger the consent provision of the Global Consent. Defendants asserted that a reverse triangular merger could not be an assignment by operation of law. The court agreed, noting, "Generally, mergers do not result in an assignment by operation of law of assets that began as property of the surviving entity and continued to be such after the merger." Furthermore, the court stated that other Delaware courts have held that, in a merger context, the non-surviving entity's rights and obligations are transferred to the surviving corporation by operation of law. Finally, the court noted that its stance was consistent with the reasonable expectation of the parties, as the vast majority of commentary indicated that a reverse triangular merger does not result in an assignment by operation of law as to the surviving entity. The court rejected plaintiffs argument that Roche's acquisition of BioVeris was merely an assignment of BioVeris's intellectual property rights based on the doctrine of independent legal significance. The court also rejected plaintiffs' reliance on forward triangular merger cases, stating that those cases involved a target company that was the non-surviving entity, whereas in this case BioVeris, the target company, was the surviving entity. The court found that plaintiffs could have negotiated for a provision that required consent based on a change in control; however, they negotiated for a term prohibiting assignments by operating of law or otherwise without consent. Therefore, the court granted summary judgment to Roche.

The court declined to grant summary judgment as to Count II because the language of the Roche License was ambiguous, the defendants did not prove that New York Law conclusively barred plaintiffs' claims and plaintiffs raised issues of material fact.

27. *Ross Holding & Mgmt. Co. v. Advance Realty Grp. LLC*, C.A. No. 4113-VCN (Del. Ch. Mar. 7, 2013) (V.C. Noble)

In this case, the court considered plaintiffs' challenge to Advance Realty Group's ("ARG") failure to repurchase the plaintiffs' units when they were terminated and to ARG's adoption of a Conversion and Exchange Agreement ("Conversion Agreement") that involved a capital restructuring of ARG that allegedly adversely affected the value of plaintiffs' ARG holdings because defendants diverted ARG's assets for their benefit. Defendants moved for summary judgment.

The court granted defendants' motion for summary judgment as to the two issues to which the court applied Delaware law—breach of fiduciary duty claims against Rayevich, a member of the ARG managing board, and against Sheridan, ARG's Chief Financial Officer ("CFO"), in connection with their alleged involvement with ARG's failure to repurchase plaintiffs' units and ARG's adoption of the Conversion Agreement.

Rayevich was bound by the ARG Operating Agreement to manage ARG reasonably and in good faith; the Operating Agreement exculpated him from liability absent willful misconduct or bad faith. The court noted that Rayevich, although a member of ARG's managing board, had no discretion in how to vote because he was required to vote as directed. Notwithstanding Rayevich's lack of discretionary voting power, the court stated that fiduciary duties extended beyond voting and could involve studying the proposed transaction, determining its appropriateness, expressing dissenting views to fellow board members and, under proper circumstances, informing unit holders about potential adverse effects. However, because plaintiffs failed to provide any facts that demonstrated Rayevich's lack of good faith in connection with the Conversion Agreement, the court granted defendants motion for summary judgment.

Sheridan did not dispute that she, as ARG's CFO, owed fiduciary duties to the plaintiffs, ARG unit holders. The court noted that fiduciary duty liability exists within the management framework of an LLC, its managing board and its unit holders. Furthermore, it stated that when a fiduciary makes misleading disclosures but no unit holder action is sought, the plaintiff must prove that the fiduciary knowingly disseminated materially false information and must prove the elements of reasonably reliance, causation and damages. Here, the court found that plaintiffs failed to demonstrate that Sheridan's alleged misstatements, omissions and misrepresentations in ARG's financial statements caused them any damage or that they relied on any of her alleged misrepresentations regarding the Conversion Agreement. The court granted defendants motion for summary judgment.

The court also addressed claims of breach of the Unit Holders Agreement and civil conspiracy under New Jersey law; the court granted summary judgment regarding breach of the Unit Holders Agreement but refused to grant summary judgment as to certain fiduciary claims against Sheridan because participation in a civil conspiracy against ARG unit holders precluded dismissing those claims.

28. *Bean v. Fursa Capital Partners, LP*, C.A. No. 7566-VCP (Del. Ch. Feb. 28, 2013) (V.C. Parsons)

Plaintiff, a limited partner in Fursa Capital Partners, LP, a Delaware limited partnership (the "Partnership"), sued the Partnership and its general partner, Fursa Advisors LLC (the "GP") for failing to receive audited financial statements as required by the Partnership's Limited Partnership Agreement (the "LP Agreement"). Plaintiff sought specific performance and alleged breach of contract and misrepresentation. The court granted plaintiff's request to review financial statements for years not barred by laches, denied plaintiff's motion for summary judgment on the breach of contract claim and granted defendants' motion to dismiss the claim of misrepresentation.

Both the LP Agreement and a private placement offering memorandum (‘PPM”) for the Partnership, an investment fund, stated that the Partnership would send audited annual financial statements to all partners within 120 days of the end of the fiscal year. Plaintiff sought to obtain these statements but did not receive the statements for years 2008-2011. Plaintiff filed suit in May 2012.

The court addressed the misrepresentation claim first. The court held that plaintiff essentially alleged a claim of promissory fraud, as he averred that the defendants knew at the time they made the representations in the LP Agreement and the PPM that they had no intention of providing the audited annual financial statements. The court found that a promissory fraud claim requires plaintiff to plead specific facts, which plaintiff failed to do. Further, the facts suggested that defendants delivered the statements for years 2005 through 2008. Finally, if defendants made the alleged misrepresentations at the time they entered into the LP Agreement and PPM, then plaintiff engaged in impermissible bootstrapping of the fraud claim to his breach of contract claim, as the contract claim rested entirely on the representation regarding defendants’ contractual obligations. The court granted defendants’ motion to dismiss the misrepresentation claim.

The court then addressed the breach of contract claim, holding that the request for the 2008 statements was barred by laches. Under the LP Agreement, the action accrued on April 30 of each year for the previous years’ financial statements. Because plaintiff did not file his complaint until May 24, 2012, his claim for the 2008 statement was barred by laches and the analogous 3-year statute of limitations. The court rejected plaintiff’s arguments regarding fraudulent concealment as he alleged no facts to support the claim. However, the court held that the requests for the 2009-2011 statement were not time-barred because it was reasonably conceivable that plaintiff did not unreasonably delay in bringing the action, as he alleged that he attempted to make several demands to the Partnership for the statements. The court also addressed plaintiff’s motion for summary judgment on the breach of contract claim. The LP Agreement appeared clear to the court in that it required the delivery of audited financial statements; however, defendants asserted that they validly amended the LP Agreement to no longer require the delivery of the statements. The LP Agreement permitted the GP to amend the agreement in any manner that did not adversely affect any partner’s rights in any material respect without that partner’s consent. Defendants did not inform plaintiff of the amendment. The court found that a genuine issue of material fact existed as to the validity of the amendment of the LP Agreement and, therefore, denied plaintiff’s motion for summary judgment.

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