2016 SPRING MEETING
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2016 Review of LLC Case Law Developments

2016 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 and annual updates are available on the Morris Nichols website at www.mnat.com/practices/commercial under Publications.

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1. *RED Capital Inv. L.P. v. RED Parent LLC,* C.A. No. 11575-VCN (Del. Ch. Feb. 11, 2016) (V.C. Noble)

Plaintiffs, RED Capital Investment L.P. ("RED Capital") and George Polk ("Polk"), claimed that RED Parent LLC ("RED Parent") violated their rights under the Amended and Restated Operating Agreement of RED Parent by denying plaintiffs' request for the books and records of its subsidiaries. RED Capital was a member of RED Parent, and Polk controlled RED Capital and was a manager of RED Parent.

The main issue in this case was whether Polk's book and records request "was made solely in his capacity as a representative of RED Capital (a member of RED Parent) or whether it was also made in his capacity as a [m]anager of RED Parent." Under Red Parent's Operating Agreement, a member's right to information was limited to the "books of account" of RED Parent. However, in Polk's capacity as a manager, Polk would be entitled to inspect RED Parent's books and records for all of the information encompassed by LLC Act Section 18-305(a) because a manager's access to information was not limited in the Operating Agreement. Section 18-305 provides that unless otherwise provided in an LLC agreement, a manager may receive certain enumerated categories of information for a purpose reasonably related to its position as manager.

The court examined Polk's books and records request to determine the capacity in which Polk made his request. In an email request to RED Parent's general counsel, Polk stated that he always acts as a member of RED Parent even while acting as a manager of RED Parent; he requested the information on behalf of RED Capital; and pursuant to his fiduciary obligations as an investor and manager of RED Parent, he made this request to "diligently reassure [himself] that all of the assets [of RED Parent] are solvent and stable." The court, while noting that the first two statements in the email request supported the proposition that he sent the request in his capacity as a representative of RED Capital, held that based Polk's third statement, the request as a whole was made both in his capacity as a representative of RED Capital and a manager of RED Parent. Thus, Polk's request was not limited by the language in the Operating Agreement restricting members' access to books and records to the "books of account" of RED Parent.

A secondary issue in this case was whether Polk was entitled to the books and records of RED Parent's subsidiaries. RED Parent was the sole member of RED Investment LLC, which in turn was a holding company for various energy companies. Red Parent argued that Polk was not entitled to subsidiary information because each subsidiary was "a legally distinct entity created for a host of legitimate business reasons." Polk argued that, under the reasoning of *DFG Wine Co. v. Eight Estates Wine Hldgs., LLC*, 2011 WL 4056371 (Del. Ch. Aug. 31, 2011), he was entitled to the books and records of RED Parent's subsidiaries. The court held that Polk was entitled to the books and records of RED Parent's subsidiaries for various reasons. First, the court stated that the facts in this case were similar to *DFG Wine Co.* because "RED Parent has no business other than those of its operating subsidiaries, RED Parent has no employees or daily operations of its own, and each entity shares the same computer system, email domain, accounting software, and director and officer insurance policy." Additionally, the court stated that

the subsidiaries also were not distinct from RED Parent because "RED Parent's operations occur[ed] solely at the subsidiary entity level" and RED Parent and the subsidiaries shared the same CEO and controller. Finally, as a manager, Polk was entitled to all information falling within Section 18-305(a)(1)-(6) that was "reasonably related to the position of manager" to the extent that such information was within Red Parent's control or was in a subsidiary's possession and control and could be obtained through Red Parent's exercise of control over the subsidiary. Thus, the court held that it would not deny Polk's request to view the books and records of RED Parent's wholly-owned subsidiary operating entities because (i) that information was "reasonably related" to Polk's position as a manager and (ii) RED Parent and its wholly-owned subsidiary operating entities had sufficient unity of control and management to properly subject the subsidiaries to a request by RED Parent's manager in accordance with Section 18-305(b).

2. *Culverhouse v. Paulson & Co. Inc.*, No. 349, 2015 (Del. Jan. 26, 2016) (*en banc*)

The Delaware Supreme Court was presented with the following certified question from the U.S. Court of Appeals for the Eleventh Circuit, which it answered in the negative: Does the diminution in the value of a limited liability company, which serves as a feeder fund in a limited partnership, provide a basis for an investor's direct suit against the general partners when the company and the partnership allocate losses to investors' individual capital accounts and do not issue transferrable shares and losses are shared by investors in proportion to their investments?

At issue in this case was the failed investment made by a hedge fund (the "Main Fund") that was a Delaware limited partnership and had a Delaware limited liability company and a Delaware corporation as its general partners and managers (the "Fund Managers"). One of the limited partners in the Main Fund was another limited liability company which acted as a feeder fund (the "Feeder Fund") to the Main Fund. Plaintiff was a member of the Feeder Fund. In response to a failed investment by the Main Fund, plaintiff sued the Fund Managers on behalf of himself and other investors alleging breach of fiduciary duty, gross negligence and unjust enrichment. The district court dismissed the complaint for lack of standing because plaintiff's claims were derivative rather than direct. The question presented to the Delaware Supreme Court arose from the perceived tension between the court's decisions in *Tooley v. Donaldson, Lufkin & Jenrette* and *Anglo American Security Fund, L.P. v. S.R. Global International Fund, L.P.*

In *Tooley*, the court established the test by which a court determines whether a claim is direct or derivative. To make that determination, a court must answer the following: (1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually)? A plaintiff must then demonstrate that the duty breached was owed to the plaintiff and that he or she can prevail without showing an injury to the entity. Since *Anglo American* was decided before *Tooley*, the court in *Anglo American* did not apply this test. In *Anglo American*, which involved a hedge fund, the court denied a general partner's motion to dismiss the direct claim of a limited partner when that limited partner had based its direct claim on a diminution of the value of its investment as a result of the general partner's overdraw of its capital account.

In addressing the certified question in this case, the court applied *Tooley* and found that although the Fund Managers owed fiduciary duties to the limited partners of the Main Fund, plaintiff was not owed such duties because he was not a limited partner of the Main Fund. As such, plaintiff would not suffer directly from the Main Fund's losses nor benefit from any recovery relating thereto. Plaintiff's recourse was not at the Main Fund level but was limited to his contractual or fiduciary relationship with the Feeder Fund and its managers. The court held that *Tooley* applied despite the structural similarities of the funds in this case and the funds in *Anglo American*¸ because the limited partners in *Anglo American* did not invest through a feeder fund, but rather had a direct relationship with the hedge fund and therefore directly suffered the alleged harm and would receive the benefit of any recovery.

3. *PECO Logistics, LLC v. Walnut Inv. Partners, L.P.*, C.A. No. 9978-CB (Del. Ch. Dec. 30, 2015) (C. Bouchard)

Plaintiff, PECO Logistics, LLC, a Delaware limited liability company, had an LLC agreement that afforded its preferred unitholders, including the defendants in this case, the right to require plaintiff to purchase all of their preferred units during a specified time period. If the put right was exercised, the LLC agreement required plaintiff to engage at its cost a nationally recognized valuation firm to determine the fair market value of the preferred units and to then purchase those preferred units at the price set by the valuation firm. Prior to exercising their put right, defendants had expressed disagreement with plaintiff regarding plaintiff's internal valuation of the preferred units. Despite this disagreement, defendants exercised the put right in a letter which provided that defendants reserved all rights with respect to the determination of the fair market value of their preferred units, including the right to participate in and object to the valuation determination.

In accordance with its LLC agreement, plaintiff's board of managers met to discuss the put and potential valuation firms. The board of managers unanimously agreed to retain Duff & Phelps after eliminating two other potential firms based on conflicts, timing and economics of each firm's proposal. Notably, defendants' representative on the board of managers participated in the selection process, but he abstained from the final selection vote. After Duff & Phelps presented their valuation report, defendants refused to tender their preferred units.

Plaintiff filed suit against defendants seeking a declaratory judgment that plaintiff complied with its LLC agreement in valuing defendants' preferred units and that defendants were bound by the agreement to tender those units at that price. Defendants counterclaimed that (i) plaintiff's pleadings raised material issues of fact because (A) the parties agreed, by virtue of defendants' reservation of rights in their put notice, to modify the LLC agreement to afford defendants the right to participate in the valuation process and object thereto and (B) the terms of the LLC agreement regarding valuation methodology were ambiguous; and (ii) that plaintiff breached the implied contractual covenant of good faith and fair dealing because (A) Duff & Phelps valued defendants' units as of a month after the put was exercised and (B) plaintiff incurred debt prior to the exercise of defendants' put right.

The court ruled against defendants on each of their counterclaims. First, the LLC agreement could only be modified with written consent of the board of managers, which consent was never given. Also, defendants' assertion that the reservation of rights contained in their put notice acted as a modification by course of conduct failed because there was no consideration for the asserted modification. Plaintiff was already obligated to engage a valuation firm to effectuate the purchase of defendants' preferred units and defendants gave nothing to plaintiff in return for the additional rights they claimed were contained in the put notice. Second, the alleged ambiguities in the valuation provisions of the LLC agreement lacked specificity, but were not ambiguous, and such provisions unambiguously vested the valuation firm with the discretion to use its judgment in setting the unit value, which was exercised reasonably. The court noted that the LLC agreement provided that the parties were bound by the decisions of the valuation firm and therefore agreed to forego any form of judicial review of that determination, which the court would respect unless bad faith was shown. Third, the valuation firm's decision to value defendants' preferred units as of a month after the put was exercised instead of another date was not precluded by the LLC agreement, nor was it an arbitrary or unreasonable decision rising to a breach of the implied contractual covenant of good faith and fair dealing. Finally, defendants failed to plead any facts that would support the inference that the debt incurred by plaintiff prior to the exercise of the put right was done in bad faith or was anything but debt incurred in the ordinary course of business. Based on the foregoing, the court dismissed defendants' counterclaims and granted plaintiff's motion for judgment on the pleadings.

4. *AM General Holdings LLC v. The Renco Group, Inc.,* C.A. No. 7639-VCN; *The Renco Group, Inc. v. MacAndrews AMG Holdings LLC*, C.A. No. 7668-VCN (Del. Ch. Dec. 29, 2015) (V.C. Noble)

The Renco Group, Inc. and its affiliates ("Renco") and MacAndrews & Forbes Holdings Inc. and its affiliates ("M&F") were engaged in a dispute about their related investments in AM General Holdings LLC ("Holdco") and Ilshar Capital LLC ("Ilshar"). Two motions were before the court: M&F's motion to compel discovery and Renco's request for a preliminary injunction requiring M&F to provide Renco with certain operating information about Holdco.

M&F's motion to compel centered on Ilshar's statement of assets and liabilities, which M&F argued it was entitled to under the informational rights provisions of the Ilshar LLC Agreement, and its request for information related to how Renco was able to post a supersedeas bond. The court granted M&F's motion to compel with regard to the former information because the court considered the information a proper objective of discovery related to M&F's claims and not privileged. However, the court denied M&F's motion with regard to the latter information because the information was neither relevant nor likely to lead to the discovery of admissible evidence.

The court also addressed Renco's request for a preliminary injunction enjoining defendants from depriving Renco of its information rights under Holdco's LLC Agreement. Renco cited to Section 10.1(a) of Holdco's LLC Agreement, which provided members the right to inspect Holdco's books and records, and Section 15.14 of Holdco's

LLC Agreement, which permitted the parties to the agreement to apply for injunctive relief. In an earlier decision in this series of disputes, the court looked to the Section 15.14 language to conclude that the irreparable injury prong of the preliminary injunction standard was satisfied. Therefore, Renco argued that its burden of showing irreparable harm was waived or otherwise satisfied for the purposes of the issue at hand. However, the court noted that the earlier decision did not establish that Section 15.14 by itself satisfied the element of irreparable harm, nor did an even earlier decision. The court pointed to language in its earlier opinions that supported a determination that "a contractual waiver provision does not necessarily satisfy the element of irreparable harm because each decision weighs it as one relevant, and sometimes significant, contributor informing whether the flexible preliminary injunction standard was met." Therefore, the court found that neither prior opinion established that the waiver provision conclusively satisfied the irreparable harm element. Because Renco did make a showing of irreparable harm because of its "informational shortage", the court denied Renco's motion for preliminary injunction.

5. *In re: New Media Books and Records Action*, Cons. C.A. No. 9984-VCN (Del. Ch. Dec. 23, 2015) (V.C. Noble)

Plaintiffs, members of defendant New Media Investors II-B, LLC ("New Media"), a Delaware limited liability company established to invest in Jenzabar, Inc. ("Jenzabar"), brought a books and records request under LLC Act Section 18-305 to seek valuation of their holdings in New Media and investigate possible misconduct by the managing member of New Media (who was also the CEO and Chairman of the Board of Directors of Jenzabar). The issue underlying plaintiffs' request involved the lapse of certain warrants received by New Media from Jenzabar without exercise.

The court noted that it could consolidate plaintiffs' seven different inspection requests into two categories—valuation and misconduct. The court found that plaintiffs had demonstrated that valuation was a proper purpose for seeking inspection of New Media's book and records, but found that plaintiff had not established by a preponderance of the evidence a credible basis to infer misconduct that would support misconduct as a proper purpose for inspection. The court stated that plaintiffs, in order to fulfill their valuation purpose, were only permitted to inspect New Media's books and records, as plaintiffs were members of New Media, and not Jenzabar's books and records. The court noted that "perhaps with evidence of wrongdoing, the inspection rights would extend to Jenzabar, but no such showing has been made. Merely sharing fiduciaries does not extend an inspection obligation from one entity to the next." The court also placed time period and record type restrictions on the books and records that plaintiffs were permitted to inspect to ensure that such books and records were "necessary, essential and sufficient" for valuation purposes.

6. *Tulum Mgmt. USA LLC v. Casten*, C.A. No. 11321-VCN (Del. Ch. Dec. 23, 2015) (V.C. Noble)

On May 29, 2015, RED Parent LLC ("RED Parent") filed an action in Illinois (the "Illinois Action") against George Polk ("Polk") and others. RED Parent brought the

Illinois Action in response to Polk, as a member of RED Parent's Investment Committee (the "Investment Committee"), requesting a valuation of RED Parent's assets pursuant to RED Parent's Operating Agreement. Polk would have the right to take control of RED Investment LLC ("RED Investment"), per RED Parent's Operating Agreement, if the valuation concluded that a "Trigger Event" had occurred. After Polk and the remaining managers on RED Parent's Board of Managers disagreed on matters relating to the valuation process, RED Parent filed the Illinois Action "to prevent Polk from acting contrary to the Operating Agreement and to ensure that the valuation process was conducted in accordance with the Operating Agreement." In July 2015, Polk filed a complaint in Delaware alleging breaches of fiduciary duty, contract and the implied covenant of good faith and fair dealing and seeking indemnification, advancement and fees on fees incurred in the Illinois Action and the Delaware Action.

In this decision, the court determined whether Polk was entitled to advancement for his litigation expenses that stemmed from the Illinois Action. Under RED Parent's Operating Agreement, Polk was entitled to indemnification and advancement in his capacity as a manager of RED Parent for actions "in connection with the business" of RED Parent. RED Parent claimed that Polk was not sued in the Illinois Action because of his status as a manager and that the Illinois Action was not in connection with the business of RED Parent, arguing instead that he was sued because of his involvement as a member of the Investment Committee. In addition, RED Parent asserted that the valuation process at the heart of the Illinois Action could result in a change in control of RED Investment, a subsidiary of RED Parent, which RED Parent asserted had nothing to do with the business of RED Parent. The court found RED Parent's arguments lacking in merit. The court stated that the valuation of RED Parent's assets, including RED Investment, was part of the business of RED Parent because RED Parent acted through its Investment Committee to conduct the valuation in accordance with its Operating Agreement. The court refused to adopt RED Parent's view that actions "in connection with the business" of RED Parent should be limited to those that directly generate income. In addition, the court noted that the "Operating Agreement does not limit advancement (or indemnification) to conduct carried out in the capacity of Manager, although one must be a Manager in order to be entitled to advancement." Therefore, the court held that Polk was entitled to advancement for his expenses incurred in defending the Illinois Action and to fees-on-fees for pursing the advancement action.

7. *ESG Capital Partners II, LP v. Passport Special Opportunities Master Fund, LP*, C.A. No. 11053-VCL (Del. Ch. Dec. 16, 2015) (V.C. Laster)

This case involved a Delaware limited partnership (the "Partnership") that was formed for the limited purpose of purchasing shares of Facebook, Inc.'s stock before its anticipated IPO. The limited partnership agreement governing the Partnership (the "LPA") provided that any distributions would be made to limited partners on the basis of their percentage interest in the Partnership. The percentage interest was measured by the number of units held by each partner as divided by the total number of outstanding units. One investor in the Partnership, Passport Special Master Fund, L.P. ("Passport Fund"), executed a side letter (the "Side Letter") with the Partnership's general partner (the "GP") that purported to grant Passport Fund preferential rights. After purchasing 452,515 pre-

IPO Facebook shares, the GP caused the Partnership to transfer one Facebook share per unit to certain limited partners (the "Favored LPs"). As a result, other limited partners (the "Disfavored LPs") received less than one share per unit or nothing at all. Upon discovering the preferential transfer, certain limited partners demanded the withdrawal or resignation of the GP. The GP agreed to withdraw and a successor general partner (the "Successor GP") was elected at a special meeting of the limited partners. The Successor GP sent a demand letter to the Favored LPs for the return of the Facebook shares that they received as a result of the preferential transfer. The Favored LPs failed to return the shares or otherwise repay the Partnership. The Disfavored LPs, the Successor GP and the Partnership filed suit against the Favored LPs, asserting claims for (i) breach of the LPA, (ii) conversion and (iii) unjust enrichment. Plaintiffs also sought a declaratory judgment that the preferential distributions violated the LPA, as well as recovery of attorneys' fees and costs under the terms of the LPA. Defendants moved to dismiss the Complaint.

The Court of Chancery first analyzed plaintiffs' breach of contract claim. Finding that defendants were parties to a contract (the LPA), the court analyzed whether plaintiffs sufficiently alleged a breach of the LPA. The court found that the plain language of the LPA's distribution provisions contemplated distributions to the partners "as a class, not as one-off transfers to certain limited partners" and that each partner would share in any distribution based on that partner's percentage interest. Thus, the court held that plaintiffs sufficiently pled a breach of contract and harm suffered, given that they received distributions in an amount less than what they were entitled to by virtue of their percentage interests in the Partnership.

To defeat plaintiffs' breach of contract claim, defendants first argued that they had an ownership interest in the Partnership's underlying Facebook shares, and thus received nothing more than what they were entitled to. The court disagreed, reasoning that the limited partners owned partnership interests, rather than rights to specific partnership assets. The court noted that Section 17-101 of the Delaware LP Act defines "partnership interest" as "a partner's share of the profits and losses of a limited partnership and the right to receive distributions of partnership assets." The court noted that the LPA reiterated the aforementioned statutory provisions, and found that no partner owned specific Partnership assets, nor could a partner seek to establish ownership rights in Partnership assets, whether by an action for partition or otherwise. The court also noted that the Private Placement Memorandum and Subscription Agreement issued to prospective investors in the Partnership stated that investors would not necessarily receive one Facebook stock for each unit they purchased.

The court then addressed defendants' argument that they received a ratable distribution in accordance with the terms of the LPA. The court rejected that argument, reasoning that the number of units a limited partner held is only an input into the percentage interest calculation, whereas the output—the percentage interest—was determinative as to what distributions the partners were entitled to. Finding that the total number of Facebook shares held by the Partnership was less than the total number of outstanding partnership units, the court reasoned that each partnership unit was entitled to only a fraction of one Facebook share, as opposed to one whole share.

Defendants further argued that Section 17-607(b) of the Delaware LP Act provided the exclusive means for challenging a distribution. The court first reasoned that Section 17-607 applied to distributions, rather than preferential transfers, and thus was inapplicable to the disputed transfer. The court also reasoned that Section 17-607(b) did not provide the exclusive means of challenging a distribution, but rather applied only to an asserted violation of Section 17-607(a). Finding that plaintiffs claimed a breach of the LPA's distribution provisions, rather than a violation Section 17-607(a), the court held that Section 17-607(b) did not preclude plaintiffs from enforcing the distribution provisions of the LPA. The court also rejected defendants' reliance on *Techmer Accel Holdings, LLC v. Amer*, 2010 WL 5564043 (Del. Ch. Dec. 29, 2010), in support of their arguments that (i) Sections 17-607 and 17-804 function to bar any other restrictions on distributions, and (ii) Section 17-607 applies exclusively until a partnership dissolves. The court noted that Delaware law presumes that provisions in a limited partnership agreement are separate and independent of statutory rights, and that while Section 17-607(a) imposes one limitation on distributions, it is not the exclusive limitation. The court again noted that 17-607 was inapplicable in any event given that the disputed transfer was not a distribution, and thus rejected defendants' Section 17-607 argument.

Defendants also argued that the LPA's dispute resolution provision established a 10-day contractual limitations period for bringing claims. The court found that the meaning of the provision was ambiguous as to whether it was intended to operate as a limitations period, and thus could not foreclose the lawsuit at this stage of the litigation. Moreover, the court noted policy concerns with enforcing such a short contractual limitations period, stating "to the extent that extrinsic evidence clarifies the ambiguity and demonstrates that it was intended to operate as a limitations period, it is possible that a ten-day limitations period could be unreasonable."

The court then considered the defenses of Passport Fund pertaining to the Side Letter, which Passport Fund argued granted them certain rights in specific assets of the Partnership. As an initial matter, the court held that an integration clause in a Subscription Agreement executed subsequent to the Side Letter nullified the Side Letter, reasoning that the Side Letter was superseded by the terms of the Subscription Agreement.

The court went on to reason that even if the Side Letter were effective, the Partnership woulc be bound only to the extent that the GP was authorized under the LPA to grant Passport Fund the rights contained in the Side Letter. The court first held that a provision in the Side Letter granting Passport Fund rights to specific assets of the Partnership was invalid. The court reasoned that the GP was not authorized by the LPA to grant such a right and that Passport Fund was aware of this lack of authorization, given that it acknowledged reading and understanding the terms of the LPA when it executed the Subscription Agreement. Moreover, the court held that the Side Letter could not bind the other non-party limited partners absent an amendment to the LPA. The court found that the LPA could not be amended by its own terms absent the consent of the majority of materially adversely affected partners, thus precluding its unilateral amendment by virtue of the Side Letter.

Passport Fund also argued that the GP was authorized to grant the rights contained in the Side Letter under a provision of the LPA that allowed the GP to conduct business with individual limited partners. The court rejected that argument, finding that the provision did not contemplate granting specific limited partners special rights, but rather allowed for the GP to contract with limited partners in alternative capacities, such as entering into a lending agreement with a limited partner. Passport Fund also argued that the LPA allowed for the GP to issue partnership securities with different rights, thus permitting the rights granted under the Side Letter. The court reasoned that although the GP was permitted to issue new securities with different rights, it was not permitted to grant special rights in partnership units to specific limited partners that other partners holding the same class of units did not enjoy. Accordingly, the court denied defendants' motion to dismiss plaintiffs' claim for breach of contract.

8. *In re: El Paso Pipeline Partners, L.P. Derivative Litigation*, C.A. No. 7141-VCL (Del. Ch. Dec. 2, 2015) (V.C. Laster)

In its April 20, 2015 decision, the court held that the sole general partner (the "General Partner") of El Paso Pipeline Partners, L.P. (the "MLP") was liable for over $171 million (the "Liability Award") for a dropdown transaction referred to by the court as the "Fall Dropdown". After that decision, Kinder Morgan, Inc., El Paso Corporation, the MLP and the General Partner consummated a related-party merger that brought an end to the MLP's separate existence as a publicly traded entity. The General Partner then moved to dismiss the litigation, contending that the closing of the merger meant that the case must be dismissed because plaintiff styled his claim as derivative. According to the General Partner, the claim that resulted in the Liability Award was exclusively derivative and belonged to the MLP; therefore, when the merger closed and the MLP's separate existence ended, control over the claim passed to an affiliate of the General Partner and extinguished plaintiff's standing to sue. The court denied the General Partner's motion to dismiss, holding that, to the extent Delaware law required the court to view the claim as "either exclusively derivative or exclusively direct", the court viewed the claim as exclusively direct because the claim that supported the Liability Award was a claim for breach of contract. Therefore, plaintiff could continue to pursue the claim after the merger closed. However, the court noted that it would be more appropriate to view plaintiff's claim as dual-natured, with aspects that were derivative for applying Rule 23.1 and demand requirements and direct for determining whether plaintiff, as sell-side investor, could continue to pursue his claim after the merger. Under this analytical framework, plaintiff could continue to pursue the claim. Under either analysis, the court could implement the Liability Award through a *pro rata* recovery in favor of the limited partners at the time of the merger who were not affiliated with the General Partner, which it ultimately did.

The court began its analysis by reciting the black-letter law: a cause of action that belongs to a corporation is a corporate asset that passes to a surviving entity in a merger. Therefore, if stockholders were pursuing a derivative claim at the time of a merger, the merger would extinguish the stockholders' claim. However, if those stockholders were pursuing an individual claim at the time of the merger, the claim was theirs and would not be extinguished by the merger. The court quoted then-Vice Chancellor Strine: "the

question of whether the plaintiffs' claims are individual or derivative becomes outcome determinative. If the claims are individual, the plaintiffs' claims survive the merger. If not, the plaintiffs' claims are extinguished." *In re Gaylord Container Corp. S'holders Litig.*, 747 A.2d 71, 82 (Del. Ch. 1999).

Here, the court noted that plaintiff proved at trial that the General Partner breached its contractual obligations under the Limited Partnership Agreement at issue. Therefore, the court stated that if it must choose between categorizing plaintiff's claim as either direct or derivative, then its decision concluded that the claim was direct because plaintiff proved that the General Partner breached a contract to which plaintiff and the other limited partners were parties. Therefore, they "were and remain entitled to enforce the terms of that agreement."

However, the court cited to a "more nuanced reason" why plaintiff should not lose standing to sue, resulting in what the court viewed as a windfall for the General Partner at the expense of the unaffiliated limited partners. That reason was that "Delaware law does not only regard claims as either exclusively derivative or exclusively direct" but regards some claims as having features of both categories, though the court conceded that such decisions were controversial. Viewing the context in which such cases arose, the court stated that this litigation arose in a similar context—where a merger extinguished the separate legal existence of the entity on whose behalf the claim was being pursued. Therefore, the court stated that plaintiff asserted a dual-natured claim that he did not lose standing to pursue after the merger closed. The court then went on to proffer a new development in how Delaware law should address dual natured claims—by characterizing such claims as derivative for purposes of claim initiation and as direct for purposes of claim termination, at least in instances where plaintiff(s) should have the option to pursue a dual-natured claim as direct after a merger.

Finally, the court addressed the General Partner's argument that plaintiff should be estopped from arguing that his claim was anything but derivative. The court found neither ground for estoppel (a representation or promise and prejudicial reliance) present.

The court stated that it would implement the Liability Award through an order requiring the General Partner to pay each limited partner that was unaffiliated with the General Partner at the time of the merger its pro rata share of the Liability Award, plus pre- and post-judgment interest through the payment date, less attorneys' fees and expenses.

9. *Finger Lakes Capital Partners, LLC v. Honeoye Lake Acquisition, LLC,* C.A. No. 9742-VCL (Del. Ch. Oct. 26, 2015) (V.C. Laster)

This case involved whether a special purpose entity's operating agreement superseded prior agreements between the parties. Zubin Mehta ("Mehta") and Gregory Shalov ("Shalov") created an asset management firm in 2003 called Finger Lakes Capital Partners, LLC ("Finger Lakes"). Finger Lakes' main capital provider was Lyrical Partners, L.P. ("Lyrical") through defendant Lyrical Opportunity Partners, L.P. After Finger Lake's portfolio companies performed poorly, Lyrical exercised its contractual rights to take control of the portfolio companies. Subsequently, one of the portfolio

companies, Revolabs, Inc. ("Revolabs"), was successfully sold. Finger Lakes and Lyrical bickered over how to distribute the proceeds. As a result of this dispute, Finger Lakes filed this action to compel Lyrical to distribute the Revolabs sale proceeds in accordance with Revolabs' Operating Agreement (the "Operating Agreement").

In addition to the Operating Agreement, Finger Lakes' and Lyrical's relationship was also governed by a term sheet between the principal of Lyrical, Jeffrey Keswin, Mehta and Shalov (the "Term Sheet") and a clawback agreement between Lyrical and Finger Lakes (the "Clawback Agreement"). The Term Sheet provided that Lyrical had a 25% interest in Finger Lakes and a right to a portion of the management fees earned by Finger Lakes. The Clawback Agreement provided that Lyrical would recoup any losses from its investments in Finger Lakes' portfolio companies before Mehta and Shalov received their appropriate distribution. The main issue in this case was whether the Operating Agreement superseded the Term Sheet and the Clawback Agreement. Finger Lakes argued that as a result of the Operating Agreement's integration clause, the Operating Agreement superseded the Term Sheet and the Clawback Agreement—thus Finger Lakes was not bound by the Term Sheet and the Clawback Agreement. The integration clause stated that the agreement superseded all prior agreements "with respect to the subject matter hereof." The court held that the "subject matter hereof" was the investment in Revolabs and that "[a]s with all of the special purpose vehicles, the scope of the governing agreement did not extend to the ongoing business relationship between Finger Lakes and Lyrical." With respect to the Term Sheet, the court noted that Mehta and Shalov abided by the Term Sheet in their interactions with Lyrical. In addition, the court stated that it was never the intent of Mehta and Shalov to supersede the Term Sheet because Finger Lakes obtained its capital from Lyrical through the Term Sheet and superseding the Term Sheet would have gone against their own interest. In regard to the Clawback Agreement, the court noted that the Operating Agreement only discussed how to distribute proceeds to the members of Revolabs. Therefore, the court held that the Operating Agreement did not supersede the Term Sheet and the Clawback Agreement.

As a secondary issue, Finger Lakes attempted to recover all fees and expenses incurred in litigating this matter before the proceeds of the sale were distributed. Pursuant to the Operating Agreement, Revolabs would indemnify Finger Lakes for all fees and expenses incurred in matters it became involved in because it was a member of Revolabs. First, the court noted that Finger Lakes was entitled to indemnification even though it is a plaintiff because there was no restriction in the Operating Agreement limiting indemnification to defendants. However, the court restricted the amount that Finger Lakes received to the legal fees and expenses incurred for the "portion of the action [that] involved Finger Lakes' status as a member and its efforts to compel a distribution in that capacity." For the part of the case that pertained to the "implications of the Term Sheet and the Clawback Agreement," the court denied Finger Lakes request for indemnification because "[t]hose agreements did not govern Finger Lakes' rights as a member of Revolabs."

10. *Intrepid Invs., LLC v. Selling Source, LLC*, C.A. No. 8261-VCN (Del. Ch. Oct. 20, 2015) (V.C. Noble)

In this case, the court resolved defendant's motion for summary judgment on plaintiff's complaint. Plaintiff was a Delaware limited liability company that sold some of its business assets pursuant to a Transaction and Purchase Agreement (the "Purchase Agreement") to defendant, also a Delaware limited liability company. In exchange for the business assets, defendant issued Class B units to plaintiff, which became the sole holder thereof. The Class B units initially represented a 15% equity interest in defendant, which was contingent upon an earn-out consideration. Upon the completion of the earn-out period, an "Earn-out Adjustment" would cause defendant to allocate its Class A and Class B units based on a ratio, which was determined by the relative earnings of the business assets as compared to those of defendant's pre-sale assets during the earn-out period. Although plaintiff was generally treated as though it held a 15% equity interest, defendant allocated 30% of its tax liability distributions to plaintiff for some portion of the earn-out period. Upon receiving unfavorable calculations and related financial information regarding the Earn-out Adjustment from defendant, plaintiff initiated arbitration in New York. The initial arbitration resulted in a ruling that plaintiff owned a 1.6% interest in defendant, which was judicially confirmed in New York.

Plaintiff then filed suit in Delaware, alleging in its complaint that defendant had breached its LLC Agreement by failing to make various tax liability distributions and cash distributions to plaintiff during the earn-out period. Defendant moved for summary judgment on plaintiff's complaint. The Court of Chancery granted summary judgment in favor of defendant, with one limited exception.

In addressing plaintiff's claim for entitlement to certain tax liability distributions from defendant, the court found that plaintiff's complaint did not seek to show that defendant improperly calculated plaintiff's tax liability. As such, the court reasoned that it merely needed to determine whether the LLC Agreement entitled plaintiff to 30% of defendant's tax liability distributions made before the Earn-out Adjustment. Finding that plaintiff failed to show how the 30% figure relating to the tax liability distributions was obtained, and that the LLC Agreement tended to support the conclusion that the parties did not intend a 30% figure based on the complexity of the provisions cited by plaintiff, the court ruled in favor of defendant's motion for summary judgment as to that aspect of plaintiff's complaint.

However, in addressing plaintiff's claim for entitlement to certain cash distributions from defendant, the court found that plaintiff's complaint might be fairly read to create a disputed fact as to whether cash distributions were ever made. The court also found that the LLC Agreement expressly entitled plaintiff to 30% of such distributions. Thus, the court denied defendant's motion for summary judgment as to the cash distribution issue, and permitted discovery to go forward on the question of whether cash distributions were made during the earn-out period.

11. *2009 Caiola Family Trust v. PWA, LLC*, C.A. No. 8028-VCP (Del. Ch. Oct. 14, 2015) (V.C. Parsons)

Plaintiff, 2009 Caiola Family Trust, a Florida trust ("CFT"), owned 90% of the membership interests of Dunes Point West Associates, LLC, a Delaware limited liability company and the owner of an apartment complex in Kansas (the "Company"). Defendant, PWA, LLC, a Kansas limited liability company ("PWA"), owned 10% of the membership interests of the Company and was its managing member. PWA itself was managed by additional defendant Ward Katz ("Katz"), who owned 10% of the membership interests of PWA and was the CEO of the Company's property manager, Dunes Residential Services, Inc. ("DRS").

Plaintiffs, CFT and its trustee, suspected PWA had caused the Company to make distributions to members that were returns of member capital rather than returns on investment, misstated the Company's finances, paid asset management fees in violation of the limited liability company agreement of the Company and caused the Company to incur unreasonable expenses. Plaintiffs contended that in addition to the foregoing, defendants failed to participate in capital calls and committed other acts which, under the limited liability company agreement, permitted the removal of PWA as managing member and the recovery of damages. Defendants disputed these allegations and claimed that plaintiffs' claims were barred by laches. Based on these claims, plaintiffs asked the court to rule on the following: (1) whether plaintiffs could remove PWA as the managing member under the limited liability company agreement; (2) whether the alleged breaches of the limited liability company agreement by PWA established a basis to award money damages to the Company; (3) whether those same facts showed a breach of Katz's fiduciary duties owed to the Company; and (4) whether either party was entitled to attorney's fees from the other party. After trial, the court made the following ruling.

First, the court agreed that PWA could be removed as managing member because Katz ceased to be actively involved with the property manager's business when the Company replaced DRS with a new property manager, which was a violation of a provision in the limited liability company agreement of the Company that required Katz to remain actively involved with the property management and granted the removal of PWA as managing member.

Second, with respect to PWA's alleged breaches of the limited liability company agreement of the Company, the court held that plaintiffs proved that PWA materially breached the provisions that only permitted payment of asset management fees when the Company had sufficient net cash flow. The other claims either were not material or were barred by laches because the financial statements provided to plaintiffs put them on inquiry notice that the Company may not have had sufficient net cash flow to warrant payment of asset management fees at the time they were made.

Third, the court held that plaintiffs failed to meet their burden to prove that Katz breached his fiduciary duty to the Company or plaintiffs as a result of the asset management fees paid by the Company to the asset manager. The court concluded that under the *In re USACafes, L.P.* line of cases, Katz, as the managing member of PWA, would owe a duty

of loyalty to the Company; however, plaintiffs' allegation that Katz caused the Company to pay the asset management fees in order to benefit his relationship with the asset manager was not supported by the facts. Plaintiffs failed to prove Katz's relationship to the asset manager was material to Katz and the asset management fees would have accrued regardless of whether they were paid out at the time they were.

Finally, the court decided to award plaintiffs only 50% of their attorneys' fees because they prevailed on their principal issue, removing the managing member, but only recovered a fraction of the money damages they sought due to laches.

12. *Corwin v. KKR Financial Holdings LLC*, No. 629, 2014 (Del. Oct. 2, 2015) (*en banc*)

Plaintiffs below appealed the Court of Chancery's dismissal of plaintiffs' complaint, which challenged the stock-for-stock acquisition of KKR Financial Holdings LLC ("Financial Holdings") by defendant KKR & Co. L.P. ("KKR"). Stockholder plaintiffs argued below that the acquisition was presumptively subject to the entire fairness standard of review because KKR was a controlling stockholder of Financial Holdings. In its opinion, the Court of Chancery granted defendants' motion to dismiss, finding that plaintiffs failed to plead facts supporting an inference that KKR was Financial Holdings' controlling stockholder. The Court of Chancery failed to find a combination of potent voting power and management control such that KKR could be deemed to have effective control of the board without actually owning a majority of stock. The Court of Chancery reasoned that plaintiffs were, at bottom, asking the Court of Chancery to impose fiduciary obligations of KKR, which owned less than 1% of Financial Holding's stock, because a preexisting contractual management agreement between a KKR affiliate and Financial Holdings constrained Financial Holdings' business and strategic options. Declining to create such a rule, the Court of Chancery held that KKR was not a controlling stockholder, and thus the business judgment rule standard of review applied to the acquisition.

On appeal, plaintiffs reiterated their controlling stockholder argument and also argued that even if KKR was not a controlling stockholder and the entire fairness standard of review was inapplicable, *Revlon* applied. Defendants argued that plaintiffs failed to fairly present their *Revlon* argument below, and, regardless, the transaction was approved by a fully informed, uncoerced stockholder vote, thus subjecting it to the business judgment rule standard of review. As to the controlling stockholder argument, the Delaware Supreme Court held that the Court of Chancery correctly applied the law and declined to repeat the Court of Chancery's analysis in its opinion. As to plaintiffs' *Revlon* argument, the Delaware Supreme Court agreed with defendants that the effect of the fully informed, uncoerced stockholder vote was outcome-determinative, even if *Revlon* applied. The court first reasoned that *Unocal* and *Revlon* were designed for pre-closing injunctive relief, rather than post-closing money damages claims as was the case here. Second, the court noted that the business judgment rule applied in these circumstances only when there was a fully informed, uncoerced stockholder vote, as opposed to a situation where "troubling facts regarding director behavior" were not disclosed to the stockholders. Finally, the court cited Delaware's long-standing policy of avoiding the "uncertainties

and costs of judicial second-guessing" in circumstances where there is a fully informed, uncoerced stockholder vote.

The court also noted that although the parties "[had] acted as if this case was no different from one between two corporations whose internal affairs are governed by the [DGCL] and related case law. . . [and that the court] respected the parties' approach", but the court recognized that the case involved alternative entities and that in such cases, "distinctive arguments often arise due to the greater contractual flexibility given to those entities under our statutory law."

13. *Matthew v. Laudamiel*, C.A. No. 5957-VCN (Del. Ch. Sept. 28, 2015) (V.C. Noble)

Aeosphere LLC (the "Company") was originally formed by Stewart Matthew ("Matthew") to develop a project called the Scent Opera, as well as collaborate with Fläkt Woods Group SA ("FWGSA"), which was interested in integrating scenting technology into its commercial air handling business. Perfumer Christophe Laudamiel ("Laudamiel") agreed to create the fragrances for the Company, and became a co-CEO. Roberto Capua ("Capua") provided funding to the Company, leaving both Matthew and Laudamiel with a 35% membership interest and Capua with a 30% membership interest. Under the limited liability company agreement of the Company (the "LLC Agreement"), certain actions, such as terminating Matthew's employment and winding up Aeosphere, required a unanimous vote of the co-CEOs, with Capua having other meaningful voting rights as a manager of the Company. The Company struggled to develop a functional product, and interpersonal strife led to Laudamiel and Capua choosing to dissolve the Company and continue with a new venture called DreamAir LLC ("DreamAir").

After protracted litigation, Matthew maintained at trial numerous claims against Laudamiel for breach of contract, breach of fiduciary duties, conversion and unjust enrichment. The court noted that earlier opinions dictated the result of Matthew's contract claims. Matthew did not vote to terminate his employment agreement, wind up Aeosphere or divide the assets where the LLC Agreement expressly required his vote on those actions. Moreover, Laudamiel shared confidential information with FWSGA in contravention of the LLC Agreement. Although the court acknowledged that Laudamiel was proceeding as a self-represented litigant, he failed to meet his burden of proving his affirmative defense of material breach by Matthew.

In regards to the breach of fiduciary duty claim, the court ruled that Matthew met the prima facie requirements for his breach of fiduciary duty claims, citing evidence that Laudamiel shared confidential information to manipulate the separation negotiating process. The court noted that Laudamiel breached his fiduciary duties "if he acted for a purpose other than to promote the best interests of [the Company]." The court briefly mentioned that if Laudamiel had chosen to retain an attorney, these claims might have been dismissed. The court awarded Matthew $491,839.79, reasoning that was the value of his 35% share of the Company.

14. *Utilisave, LLC v. Miele*, C.A. No. 10729-VCP (Del. Ch. Sept. 17, 2015) (V.C. Parsons)

Plaintiff Utilisave, LLC ("Utilisave") was a Delaware limited liability company that audited utility bills to help customers find savings. Defendant Donna Miele was a former employee and member of Utilisave. Her membership in Utilisave terminated in July 2012 by court order and she executed an Assignment and Termination of Membership Interest (the "Assignment Agreement"), but she continued as a Utilisave employee until she resigned in October 2014. After her resignation, Miele allegedly began to compete with Utilisave, and Utilisave filed suit against her for breach of a confidentiality provision in Utilisave's operating agreement (the "LLC Agreement"). Before the court was defendant's motion to dismiss plaintiff's claim for specific enforcement of the confidentiality provision and its motion to dismiss plaintiff's claim for monetary damages. The court denied the former motion and granted the latter.

The confidentiality provision in the LLC Agreement provided that, for as long as Utilisave was engaged in the "Utilisave Business" (as defined in the LLC Agreement), a member would not disclose any confidential information, subject to certain qualifications. The provision was to survive the termination of Utilisave and continue to be binding on a member following the termination of the member's interest in Utilisave. Utilisave alleged Miele breached this provision by contacting one of Utilisave's longstanding clients shortly after her resignation. Miele moved to dismiss this claim, arguing that the confidentiality provision was unenforceable because the assignment of her membership interest under the Assignment Agreement terminated the confidentiality provision or, alternatively, that if the confidentiality provision survived the assignment, it was unenforceable because it was overbroad and unreasonable.

In response to Miele's motion to dismiss, Utilisave contended that the confidentiality provisions explicitly states that it will "survive the termination of [Utilisave] and…continue to be binding on a Member following the termination of [her] interest in [Utilisave]." In addition, Utilisave denied Miele's assertion that the confidentiality provision is a de facto non-compete or non-solicitation covenant, and that in any event such a fact-intensive issue could not be resolved on a motion to dismiss.

The court first addressed Miele's contention that the Assignment Agreement terminated the confidentiality provision. It found that Miele's argument was reasonable, since the Assignment Agreement provided that upon the assignment, her membership interest would automatically terminate and Utilisave's records should be updated to reflect her membership interest as having been liquidated, terminated, and retired for all purposes. Additionally, the Assignment Agreement did not preserve or carve out the confidentiality provision in any fashion. Miele's argument was further supported by the fact that the Assignment Agreement defined her membership interest to include all obligations under the Assignment Agreement, including the confidentiality provision. However, the court also found Utilisave's interpretation that the confidentiality provision survived termination to be reasonable based on a plain language reading of the confidentiality provision. The confidentiality provision stated that it survived termination and the Assignment Agreement stated that it terminated the LLC Agreement without clarifying whether that included the confidentiality provision. As movant, Miele had the burden of

showing that her interpretation of the Assignment Agreement was the only reasonable one, and since she failed to meet this burden, the court rejected this prong of her motion to dismiss.

The court then considered Miele's argument that the confidentiality provision was overbroad and unreasonable. Because the provision contained terms that appeared to be aimed at preserving Miele's ability to compete reasonably, the alleged breach occurred relatively soon after the termination of her membership interest, and Utilisave could reasonably show that enforcing the confidentiality provision would protect its legitimate economic interests and did not unduly burden Miele, the court found that the confidentiality provision was not overbroad or unreasonable with respect to Miele's alleged breach through the use of Utilisave's confidential client contact information. The court also rejected Miele's argument that the provision was unenforceable as a matter of law because the nature of some of Utilisave's confidential information was such that Miele could not compete with Utilisave without breaching the provision.

The court then determined that it was reasonable to infer from the complaint that Miele used Utilisave's confidential information for her own account, and therefore found that Utilisave pled sufficient facts to support its claim for specific performance. Since plaintiff pled the existence of an agreement – the LLC Agreement – that provided that breach of the confidentiality provision would cause irreparable injury justifying specific performance, the court found it reasonably conceivable that Utilisave would prove its entitlement to this remedy, and thus dismissed defendant's motion to dismiss on this issue. However, because Utilisave failed to plead facts supporting a reasonable inference that Miele's breached caused it economic harm, the court dismissed Utilisave's claim for damages.

15. *In re Kinder Morgan, Inc. Corporate Reorganization Litig.*, C.A. No. 10093-VCL (Del. Ch. Aug. 20, 2015) (V.C. Laster)

This case arose from allegations by plaintiff that the conflicts committees of certain related entities failed to act in good faith when approving a corporate reorganization (the "Transaction") of publicly traded entities that resulted in Kinder Morgan, Inc. ("Parent") emerging as the sole publicly traded entity and two entities controlled by Parent—Kinder Morgan Energy Partners, L.P. (the "Partnership") and Kinder Morgan Management, LLC ("GP Delegate"), the delegatee of the management authority held by the general partner (the "GP") of the Partnership—becoming indirect subsidiaries of Parent. As part of the Transaction, Parent paid unitholders of the Partnership and shareholders of GP Delegate roughly equivalent consideration with GP Delegate shareholders receiving their consideration tax-free, despite the shares in GP Delegate trading at a discount to the Partnership's common units. Because Parent was acquiring 100% ownership of the Partnership and also controlled the Partnership through the GP, the Transaction created a conflict of interest for the GP. According to the Partnership's limited partnership agreement (the "LPA"), the GP could address this conflict by seeking special approval of a majority of the members of the Partnership's conflicts committee. The conflicts committees of the GP and GP Delegate consisted of members of the board of directors of the GP who were not officers or employees of the GP, GP Delegate or their affiliates.

Plaintiffs alleged that the members of the conflicts committees were conflicted because of their simultaneous roles on both committees and compounded this conflict by only engaging a single financial adviser and single set of legal advisors to assess the Partnership and GP Delegate aspects of the Transaction. As a result of this conflict, the committees allegedly failed to act in good faith by (i) completing the negotiation and evaluation of the Transaction on a compressed timeline, (ii) agreeing to GP Delegate's shareholders receiving greater net consideration (after taxes were calculated) than the Partnership's unitholders despite the historical discount on GP Delegate shares and (iii) focusing on provisions in the merger agreement that were unlikely to have much real-world consequence instead of negotiating a greater premium for the Partnership's unitholders or more relevant unitholder protections.

The court, relying on Delaware Supreme Court precedent interpreting identical limited partnership agreement provisions, held that default fiduciary duties had been eliminated in the LPA and therefore no claim of a breach of fiduciary duties existed. The LPA instead imposed contractual obligations on the GP to act in manner that it reasonably believed to be in, or not inconsistent with, the best interests of the Partnership. The standard imposed by the LPA required the conflicts committee to make a determination as to the fairness of the Transaction to, and the best interests of, the Partnership, and not the Partnership's unitholders. Since plaintiffs' allegations were focused on the effect of the Transaction on the Partnership's unitholders rather than the effect on the Partnership, the court dismissed the claims. The court also dismissed plaintiffs' claim that the GP breached the implied covenant of good faith and fair dealing because the allegations failed to identify a sufficient conflict faced by members of the conflicts committees.

16. *Utilisave, LLC v. Khenin*, C.A. No. 7796-ML (Del. Ch. Aug. 18, 2015) (M.C. Legrow)

Plaintiff Utilisave, LLC ("Utilisave") was a Delaware limited liability company that audited utility bills to help customers find savings. Plaintiff MHS Venture Management Corp ("MHS") was a corporation wholly-owned and managed by Michael Steifman, who founded Utilisave and promoted defendant Mikhail Khenin to CEO in 2003. MHS had a 50 percent membership interest in Utilisave, Khenin a 40 percent interest, and Utilisave President Donna Miele a 10 percent interest. Steifman and Khenin entered into an Amended and Restated LLC Agreement of Utilisave (the "Operating Agreement") and separate employment agreements in 2006. Under the Operating Agreement, they were the co-managing members of Utilisave, which meant that Khenin could not take certain actions without approval from MHS. The Operating Agreement also provided that all distributions were to be made at the discretion of the majority of the members, and because MHS controlled a 50 percent interest in Utilisave, Khenin and Miele could not achieve the majority vote required to take these actions without approval from MHS.

The relationship between Steifman and Khenin soured in 2007, when Khenin began to exclude Steifman from the business. Khenin purported to fire Steifman and to unilaterally extend his employment agreement when it expired in January 2009. After he assumed sole control of Utilisave, Khenin unilaterally declared six distributions to Utilisave's members and continued to serve as de facto CEO of Utilisave until August 2011, when he was removed from this position by court order.

In a separate action in New York against Utilisave and Khenin, MHS and Steifman brought claims to recover unpaid distributions and to obtain a declaratory judgment that Khenin's unilateral extension of his Employment Agreement was unauthorized. In June 2011, the New York court entered a declaratory judgment that the extension was unauthorized and that Khenin wrongfully withheld portions of MHS's distributions to fund Utilisave's defense of the New York action.

There were multiple prior actions in the Delaware Court of Chancery as well. First, MHS filed a petition for dissolution of Utilisave in March 2009. In August 2011, the court appointed a liquidating trustee and appointed Steifman as interim CEO of Utilisave. After rejecting multiple requests for a distribution from Khenin, the trustee moved forward with a plan to sell Utilisave or its assets. MHS was the only bidder, and the trustee recommended the sale of Utilisave as a going concern to MHS, which would purchase all the assets and liabilities of Utilisave in exchange for waiving its priority claim to all proceeds from the sale of the company and any legal claims it or Steifman had against Utilisave. Khenin objected to the sale, arguing that only the dissolution of Utilisave was permitted. The Chancellor rejected this objection, explaining that the purpose of dissolution proceedings was to create an economically productive resolution and that the form is not critical. The transaction closed on July 9, 2012 and MHS became the sole owner of Utilisave.

Plaintiffs then filed this action against Khenin in the Court of Chancery, alleging nine counts, including breach of the fiduciary duty of loyalty and various breach of contract claims that included allegations of breach of the Operating Agreement. The dispute was referred by the court to a Master in Chancery (the "Master"), whose report on plaintiffs' motions and post-trial report are summarized here. Khenin counterclaimed that Steifman breached the Operating Agreement by failing to make a distribution after Steifman was appointed CEO. Then-Chancellor Strine dismissed the counterclaim as a matter of law, finding it to be an unreasonable reading of the Operating Agreement, and Khenin re-pled two counterclaims after being granted leave to do so. Before the court was plaintiffs' motion for partial summary judgment on six of the nine counts.

Plaintiffs' first count alleged Khenin breached his fiduciary duty of loyalty to Utilisave by incorporating a new business called Benchmarking Solution Services, Inc. ("Benchmarking") under his own name, issuing all authorized shares in Benchmarking to himself, and arranging for Benchmarking's bank statements to be mailed to Khenin's home address. Khenin admitted he opened Benchmarking for himself, and plaintiffs claim that by doing so he usurped a corporate opportunity of Utilisave. The Master denied plaintiffs' motion on this count, since plaintiffs did not suggest Utilisave lost any business to Benchmarking and the trustee recovered the approximately $30,000 that was in Benchmarking's bank account.

In a separate count, plaintiffs alleged Khenin breached the Operating Agreement by unilaterally making distributions during 2010 and 2011 without authorization from a majority of the members. Section 3.3 of the Operating Agreement provided in part as follows: "All distributions will be made at the discretion of the majority of the Members. It will be presumed that cash in excess of required working capital will be distributed

unless there is a compelling reason to accumulate additional cash reserves." Khenin argued that the first sentence should be read to apply only to "discretionary" distributions, while the second sentence should be interpreted to apply only to "mandatory" distributions. Thus, he argued, when a majority vote could be obtained, the distribution of all excess cash was required, and as CEO he had the authority to unilaterally make that decision.

The Master rejected this interpretation. First, she noted that the earlier decisions by the New York Court and the Court of Chancery mandated a conclusion that no distributions could be issued without MHS's approval. However, even if these decisions did not collaterally estop Khenin from making this argument, the Master found under her own independent reading that the challenged distributions were unauthorized because the unambiguous language of the Operating Agreement provided that all distributions were discretionary. The second sentence merely explained a "presumption" that the parties agreed would apply in determining the amount of the discretionary distributions. Thus, the Master concluded that Khenin made several unauthorized distributions, but recommended that the Court of Chancery award only nominal damages of $1 since plaintiffs did not show that Utilisave was harmed by the distributions.

The Master then addressed Khenin's counterclaims. His first counterclaim had two parts. First, he argued that Utilisave was required to make a distribution during the pendency of the dissolution action under Section 3.03 of the Operating Agreement. He claimed that, by the time Steifman was appointed as acting CEO, Utilisave had accumulated cash in excess of required working capital, and that the cash should have been distributed to the members. However, when Khenin requested that the trustee issue a distribution in February 2012, the trustee declined to do so, reasoning that Utilisave could require funds in excess of the agreed amount of working capital to cover liquidated-related expenses and possible litigation. The Master dismissed this prong of the counterclaim, finding that plaintiffs' arguments were collaterally estopped by the New York's court's interpretation of Section 3.03 of the Operating Agreement and by then-Chancellor Strine's interpretation of this section. Khenin also argued that Miele had no right to a final distribution of approximately $15,000 she received from Utilisave in December 2012, since her interest in Utilisave was cancelled five months prior pursuant to the sale to MHS. Steifman characterized that payment as an employment bonus. Although the Master found the timing of the payout curious, because MHS fully owned Utilisave, the Master found it was free to pay distributions or bonuses to its employees at its discretion.

The Master also rejected the second part of Khenin's first counterclaim, in which he argued that Utilisave breached Section 6.04 of the Operating Agreement, which provided that "[u]pon dissolution of the Company a proper accounting shall be made by the company's accountants of the Company's assets, liabilities and operations." Because Utilisave was sold to MHS and remained a going concern, no accounting was required.

In his second counterclaim, Khenin argued that Utilisave breached Section 6.05 of the Operating Agreement by failing to distribute the company's remaining assets – approximately $800,000 in cash and $2.9 million in accounts receivable, as determined by the trustee's final accounting – to the members after the sale. He claimed that in order

to realize its priority claim, MHS had to actually pay cash consideration for the assets, but the court rejected this argument because it would elevate form over substance. Khenin then argued that the sale of Utilisave to MHS did not extinguish his claim under Section 6.05 of the Operating Agreement because the court order approving the sale specifically stated that it was without prejudice to Khenin's claims against Utilisave, including his claims for distributions. As such, Khenin claimed that Utilisave's remaining assets were available for distribution after the sale to MHS and, because Steifman waived his priority claim in connection with the sale, the priority claim did not reduce the assets available for distribution. The Master rejected this argument, finding that once Utilisave's assets were sold, there were no assets left to distribute under Section 6.5. Although the court in approving the sale did so without prejudice to the claims, it made no finding as to the merit of those claims.

17. *Jagodzinski v. Silicon Valley Innovation Co., LLC*, C.A. No 7378-VCP (Del. Ch. Aug. 7, 2015) (V.C. Parsons)

Defendant, Silicon Valley Innovation Company, LLC, was placed into receivership in early 2013 at the request of plaintiff, a majority unitholder. Plaintiff's request was prompted by the alleged self-dealing and looting of defendant. The appointed receiver, Bram Portnoy, was an employee of plaintiff at the time of his appointment. As receiver, Portnoy commenced litigation against many of defendant's former officers and directors including a case in California that had a potential recovery of over $100 million. Subsequently, the receiver's compensation, initially paid on an hourly rate, was changed, by an order of the court, to a flat monthly rate with a contingent bonus for monies collected through litigation. In this action, plaintiff moved to terminate the receivership, or in the alternative, to reduce the receiver's compensation. The court denied plaintiff's motion to terminate the receivership; however, it did alter the receiver's compensation.

First, the court analyzed plaintiff's motion to terminate the receivership. As the standard for terminating a receivership in the LLC context was a novel issue, the court looked at corporate law to determine the proper standard. The court held that "once established, a receivership should continue in the discretion of the [c]ourt until its purpose has been fulfilled, at which time the [c]ourt ought to discharge the receiver." The court noted "that such discretion should be exercised sparingly and with caution." Plaintiff argued that the receivership should be terminated because the alleged looting and self-dealing that prompted the receivership had ceased. The court, while recognizing that the looting and self-dealing had concluded, denied plaintiff's motion because "the task of gathering and disposing of [defendant's] assets through litigation is ongoing." In addition, in expounding on its decision to deny plaintiff's motion, the court noted the following: Portnoy investigated the claims and commenced the pending lawsuits; Portnoy likely would have a role in the lawsuits going forward; plaintiff, in his motion to place defendant in receivership, asked the court to appoint Portnoy as the receiver; and "ending the receivership likely would place [defendant] at serious risk of promptly being placed into bankruptcy" because of the substantial pending claims against defendant.

Second, the court ruled on plaintiff's motion to alter Portnoy's compensation. Plaintiff contended that Portnoy should not receive a 10% fee for monies collected through

litigation. This motion stemmed from the lawsuit that was pending in California with a potential $100 million recovery. The court first noted that receivers are entitled to reasonable compensation and the goal of the court in setting a contingency fee was to align a receiver's incentives "with the stockholders to seek the best risk-adjusted recovery without granting [the receiver] a windfall." The court, taking into account the potential $100 million recovery, held that the 10% contingency fee was reasonable. However, the court did adjust the contingency fee to "10% of the monies collected by [defendant,] net of the fees paid to Portnoy henceforth and any out-of-pocket expenses incurred in the administration of [defendant's] estate, including non-contingent attorney's fees and costs and expert witness fees actually paid by or for [defendant,] but not including the contingent recovery of the lawyers who have contingent fee arrangements." Finally, the court held that Portnoy was required to accurately keep track of his hours and prepare monthly invoices for all hours worked for defendant.

18. *Barry Henson, et al. v. Filomena Sousa, et al.*, C.A. No 8057-VCG (Del. Ch. Aug. 4, 2015) (V.C. Glasscock)

Plaintiffs, Barry Henson and Walkabout II Pty Limited, sued defendants, Filomena Sousa and Daniel Wilkinson, for malfeasance related to Talsico, LLC (the "Company"). Henson, Sousa and Wilkinson were members of the Company. In an earlier order, the court placed the Company in receivership and ordered the receiver to marshal the Company's assets for the benefit of creditors and for distribution. Pursuant to that order, the receiver had plenary authority over the affairs of the Company; however, the court had final say on indemnification and advancement disputes.

In this case, the court addressed defendants' request for advancement of their defense costs arising from plaintiffs' malfeasance claims. The court denied the defendants' request on two grounds. First, the court held that a right to advancement must be set forth in an LLC agreement and because defendants' contested the validity of the LLC agreement on which they relied to receive advancement costs, the court held that it would be inequitable to provide defendants with a right to advancement based on the disputed agreement. Second, the court denied defendants' request because of creditors' interests in the assets of an LLC in receivership. Defendants' argued that advancement rights have priority over rights of any creditors. However, the court, adopting the rationale of *Andrikopoulos v. Silicon Valley Innovation*, C.A. No. 9899-VCP (Del. Ch. July 30, 2015), stated "that equity and public policy favored treating advancement claims as, in effect, indemnification claims in this limited circumstance, relegating those claims to an equivalency with other creditors' claims." For those reason, the court denied defendants' advancement request.

19. *Branin v. Stein Roe Inv. Counsel, LLC*, C.A. No. 8481-VCN (Del. Ch. July 31, 2015) (V.C. Noble)

In this decision, the court addressed whether accrual of a right to indemnification for purposes of the statute of limitations naturally flows from the vesting of a right to indemnification for purposes of coverage. The court held that it does not.

Plaintiff began working for defendant Stein Roe Investment Counsel LLC (the "Company") in 2002 and, shortly thereafter, he was sued by his former employer. Plaintiff defended himself against his former employer's allegations for ten years and, ultimately, all claims against plaintiff were dismissed. Plaintiff sought indemnification against defendants under a purported right to indemnification under the Company's limited liability company agreement (the "LLC Agreement"). In its July 30, 2014 decision (the "2014 Decision"), the court found that the first amendment to the LLC Agreement dictated plaintiff's indemnification rights, not the second amendment to the LLC Agreement that purported to remove plaintiff's indemnification rights related to his dispute with the former employer. However, based on the facts before it, the court could not resolve whether plaintiff was entitled to indemnification under the first amendment standard—that the party seeking indemnification must have acted in good faith on the Company's behalf and in a manner reasonably believed to be within the scope of the party's authority. The parties agreed to a stipulation and order on liability, which resolved those factual issues in plaintiff's favor. Defendants then amended their answer to add statute of limitations as an affirmative defense, and the parties cross-moved for summary judgment.

The court stated that the central issue to be resolved was whether the three-year statute of limitations on plaintiff's indemnification claim began to run when his contingent right to indemnification vested in 2002. The court noted the statute of limitations began to run when plaintiff could be confident any claim against him was resolved with certainty and found that plaintiff could not have enforced his right to indemnification until the nature of his conduct was determined in the action with his former employer, which was not dismissed until 2012.

The court then analyzed the applicability of the "law of the case doctrine"—that "once a matter has been addressed by a court, it is generally held to be the law of that case and will not be disturbed by that court unless compelling reason to do so appears"—because defendant argued that, in the 2014 Decision, the court held that plaintiff's right to indemnification vested in 2002 and, therefore, the three-year statute of limitations had run. The court rejected this argument, finding that "the vesting of a right under contract and the accrual of a claim for statute of limitations purposes are not inextricable tied together." In contrast to when a contractual right to indemnification is confirmed (in this case, the LLC Agreement indemnification provision in place when the conduct giving rise to the claim for indemnification occurred), a plaintiff must be able to bring suit for the statute of limitations on an indemnification claim to begin to run. Here, plaintiff could not have filed his indemnification action until the litigation concluded in 2012 because the court would have been unequipped to determine whether plaintiff's conduct had met the requisite standard for indemnification.

The court also found that, even if plaintiff's claim for indemnification accrued for statute of limitations purposes in 2002 (which it did not), defendants had a continuing duty to indemnify plaintiff under the theory of continuing breach.

Because plaintiff's claim for indemnification was timely, the court granted plaintiff's motion for summary judgment and held that he was entitled to prejudgment interest and fees on fees.

20. *Andrikopoulos v. Silicon Valley Innovation Company, LLC*, C.A. No. 9899-VCP (Del. Ch. July 30, 2015) (V.C. Parsons)

Silicon Valley Innovation Company, LLC (the "Company") was placed in receivership and its only assets were contingent claims against the Company's former officers and directors. The Company filed a lawsuit against two previous employees of the Company. Those former employees sued the Company for advancement of their legal expenses. The main dispute before the court was (i) whether, in the context of a receivership estate under Delaware law, advancement claims were administrative expenses or unsecured creditor claims, and (ii) if plaintiffs' claims were administrative expenses and afforded priority, whether the receiver's salary and expenses still had priority over those claims.

The Company argued that advancement was a pre-petition claim because it was based on conduct that occurred before receivership and was essentially a form of compensation for services rendered before receivership. Thus, the Company maintained that plaintiffs' claims should be paid pro rata with other unsecured creditors as would be the case in the bankruptcy context. Plaintiffs countered that these advancement obligations arose a part of the administration of the estate and the pursuit of the Company's only assets (contingent claims against management), and should therefore be paid on par with the receiver's compensation.

The Delaware LLC Act, and even the DGCL, provided little statutory guidance for the court; it therefore looked to case law and analogous circumstances in bankruptcy to inform its decision. The court ruled that plaintiffs' advancement claims should be treated on par with those of other unsecured creditors and not given priority. First, while the court acknowledged Delaware's strong public policy in favor of advancement, in the context of receiverships the justification for advancement as an inducement to attract qualified management is diminished in the face of the goal of winding up the company. Second, the Company pre- and post-receivership was governed by different individuals and different sets of rules; therefore, similar to the bankruptcy context, contractual advancement obligations were no different than other creditor claims. Third, the court recognized that although this result may frustrate advancement expectations, the best solution in the context of seeking advancement from an insolvent entity was insurance. Finally, the reality of practical administration weighed in favor of denying plaintiffs' claims because the court would otherwise have to engage in line-item accounting over the priority of various administrative expenses. Accordingly, plaintiffs' were treated as if they were any other unsecured creditor and not afforded priority.

21. *NewYork.com Internet Holdings, Inc. v. Entertainment Benefits Group, LLC*, C.A. No. 10206-VCP (Del. Ch. July 8, 2015) (V.C. Parsons)

NewYork.com Entertainment Group, LLC (the "Company") was formed by its members to hold all rights and title to the internet domain name NewYork.com. The members of

the Company, NewYork.com Internet Holdings, Inc. ("NYIH") and Entertainment Benefits Group, LLC ("EBG"), each owned fifty percent of the membership interests in the Company and each appointed a representative to the two-member board of directors—NYIH's board member was Tom Stafford ("Stafford") and EBG's board member was Brett Reizen ("Reizen"). Under the limited liability company agreement of the Company (the "LLC Agreement"), EBG was granted exclusive authority to manage the day-to-day operations of the Company. The LLC Agreement also provided for certain events that would cause NYIH to offer its fifty-percent membership interest to EBG at a specified price (the "Triggering Events"). The relevant Triggering Events were (i) if NYIH engaged in any conduct which in EBG's reasonable opinion reflected unfavorably on the good name, goodwill or reputation of the Company or EBG, or their respective affiliates and (ii) if NYIH beached any of its obligations under the LLC Agreement.

In this case, the court addressed whether EBG's claims that Triggering Events occurred could survive a motion to dismiss. First, EBG averred that NYIH and Stafford acted in a manner that reflected negatively on the good name, goodwill and reputation of the Company and EBG because (i) Stafford acted abusively to the Company's information technology provider, (ii) Stafford acted abusively toward Reizen at a board meeting, (iii) Stafford disclosed the dispute between NYIH and EBG to a former Company employee and (iv) NYIH attempted to obtain Company books and records though an individual unaffiliated with NYIH. Second, EBG alleged that NYIH breached the LLC Agreement by failing to recognize EBG's exclusive management authority, NYIH's disclosure of confidential information to a third party and NYIH's failure to provide timely notice of the alleged triggering events, as provided in the LLC Agreement.

The court ruled that EBG sufficiently pleaded that Triggering Events occurred that would force NYIH to sell its interests in the Company to EBG. Although the court was not confident these claims would survive, the facts alleged required that the motion to dismiss be denied.

22. *CMS Inv. Holdings, LLC v. Castle*, C.A. No. 9468-VCP (Del. Ch. June 23, 2015) (V.C. Parsons)

This case involved a dispute between plaintiff, an investor in a Delaware LLC, RP Holdings Group, LLC ("RPH"), and several defendants that managed RPH together with law firms run by such defendants and their holding companies. RPH was in the business of providing non-legal services to law firms, including law firms run by defendants. RPH was managed by a board of managers (the "Board of Managers"). Plaintiff, who owned most of the Class A units in RPH, had the right to appoint three members to the Board of Managers, and two defendants served as appointees of the Class B unitholders. These two defendants together with other defendants provided services to and consulted for RPH as members of an "Operating Board," which allowed them to work as independent contractors while exercising control over the day-to-day operations of RPH.

Plaintiff alleged that although RPH's business was performing remarkably well during the 2008 recession, defendants failed to pay RPH for the services it provided to law firms

run by defendants. Plaintiff further alleged that defendants diverted those fees away from RPH and instead paid themselves directly. Although RPH accrued substantial accounts receivable balances, plaintiff and its appointees to the Board of Managers relied on defendants' reassurances that they would make good on the fees owed to RPH. In 2011, plaintiff's suspicions were corroborated by an accounting firm that they hired to investigate RPH's operational efficiency issues—particularly in regards to its accounts receivable collections processes—which found that defendants were indeed retaining all or part of the payments owed to RPH. The accounting firm also found that defendants had intentionally concealed RPH's true financial condition from plaintiff and its appointees on the Board of Managers.

In 2012, RPH defaulted on a credit agreement it entered into with Freeport Financial, which allowed Freeport Financial to foreclose on RPH's collateral. Plaintiff claimed that defendants secretly engaged in a self-dealing scheme with Freeport Financial to orchestrate the sale of the still-valuable services businesses to defendants while leaving RPH, and by extension plaintiff, empty-handed.

Plaintiff filed suit against defendants in March 2014, charging them with a myriad of claims, including: breach of contract, breach of the implied covenant of good faith and fair dealing, unjust enrichment, breach of fiduciary duties, aiding and abetting, civil conspiracy, and fraudulent transfer. Defendants moved to dismiss plaintiff's complaint as it related to them.

As an initial inquiry, the court found defendants' arguments that plaintiff's claims were derivative—rather than direct—to be unpersuasive. In applying the Tooley analysis, the court found that plaintiff's claims were more direct than derivative in nature, and at least dually direct and derivative. The court reasoned that if plaintiff's fiduciary duty and breach of contract claims are proven, then the Class A unitholders—including plaintiff—would recover individually rather than on a pro rata basis. In this regard, these claims were largely based on distributions that should have been made to plaintiff as a Class A unitholder but were improperly distributed to certain defendants. The court found that the predominant harm thus fell upon the Class A unitholders, despite defendants' argument that RPH itself was harmed.

The court then addressed defendants' arguments for dismissal of plaintiff's claims for breach of contract, breach of implied covenants and unjust enrichment. With regard to the breach of contract claims, a defendant on the Board of Managers argued that although his holding company, LEC Holdings, LLC ("LEC"), was bound as a member of RPH by being a signatory to the LLC agreement of RPH, he was personally not bound by the LLC agreement because he was not a party to it, and therefore could not be liable for any alleged breaches thereof. Citing Section 18-101(7) of the Delaware LLC Act, the court reasoned that his role as a member of the Board of Managers bound him to the LLC agreement. Certain other defendants conceded that they were bound but argued that the breach of contract claims against them must be dismissed because the relevant sections of the LLC agreement bound the Board of Managers and not such defendants as members. However, these defendants did have positions on the Operating Board and the court found that their positions of influence in the operational structure of RPH could lead to a

plausible inference that they caused improper distributions in contravention of the provisions of the LLC agreement. As to another defendant, Caren Castle ("Castle"), despite her role as a member of the Operating Board and a high-level executive of RPH, the court found nothing in the record to support a reasonable inference that she intended to be bound by the LLC agreement of RPH as she was not directly a member or on the Board of Managers.

In regards to the breach of implied covenants claims against defendants, the court noted that the implied covenant requires a party in a contractual relationship to refrain from arbitrary or unreasonable conduct which has the effect of preventing the other party to the contract from receiving the fruits' of the bargain. For this claim, the court looked to an opinion (the "Opinion") that was received in connection with the formation of RPH that outlined the structure of the intent of RPH. In this regard, the court found that compliance with the Opinion was an implied term of the LLC agreement and that defendants breached the implied covenant by receiving fees directly instead of properly channeling them through RPH. In this regard, the court found that defendants frustrated the overarching purpose of the LLC agreement as evidenced by the Opinion by taking advantage of their positions to control implementation of the LLC agreement's terms. However, the court did dismiss the claim against Castle, as it reasoned that one cannot breach an implied covenant of an LLC agreement if that defendant is not bound by the express terms of the agreement.

The court next turned to fiduciary duty claims brought by plaintiff. It found that the LLC agreement did not alter the traditional standards of care underlying the fiduciary duties of care and loyalty. Relying on that finding, the court then found that defendants on the Board of Managers were fiduciaries given their role as members of the Board of Managers. The court also found that certain other defendants, including Castle, were fiduciaries through their roles as high-level officers of RPH. In addition, the court found that one defendant acted as a fiduciary through his role as CEO of a particular region because he was "vested with discretionary power to manage the business of the LLC." However, the court noted that a more fully developed record could contradict this finding at a later procedural stage. Finally, the court dismissed plaintiff's breach of fiduciary duty claims against the holding company defendants, reasoning that neither entity was a managing member of RPH, nor were they in a position to exercise control over the business and affairs of the LLC.

Concerning defendants' alleged breaches of fiduciary duty, the court found that, assuming plaintiff's factual pleadings were true, certain defendants could have plausibly breached their fiduciary duties by purposefully taking action to force RPH into insolvency and colluding with Freeport Financial to purchase its business assets at a favorable price out of receivership. The court similarly reasoned that a defendant member of the Board of Managers could have breached his fiduciary duties by failing to do more than simply resign from his position as a Board member if he was privy to the other defendant's machinations.

Reasoning that one cannot have both direct and secondary liability for a breach of fiduciary duty, the court dismissed the aiding and abetting claims against defendants who

were found by the court to be fiduciaries. However, the court held that if the record later reflected that Castle and another defendant were not fiduciaries to RPH, they could very well be secondarily liable under the aiding and abetting theory. In regard to the individual defendants' various affiliated entities, such as the various law firms and holding companies, the court noted that secondary liability could exist where an entity acts as "'middleman for and beneficiary of improper disbursements by' the allegedly faithless fiduciaries with which they are affiliated." Thus, the court denied those entity-defendants' motions to dismiss plaintiff's aiding and abetting claim.

23. *Meyer Natural Foods LLC v. Duff*, C.A. No. 9703-VCN (Del. Ch. June 4, 2015) (V.C. Noble)

Respondents Kirk Duff, Todd Duff, and C.R. Freeman entered into a business relationship with petitioner Meyer Natural Foods LLC ("Meyer") to sell beef to a national grocery chain in 2011, formalized through three agreements: a Purchase Agreement, which focused on Respondents' sale of a 51% interest in Premium Natural Beef, LLC ("PNB") to Meyer; the PNB LLC Agreement, which set out the details of PNB's business, with Meyer as managing member; and the Output and Supply Agreement, under which separate companies (the "Respondent Companies") owned by the Duffs and by Freeman were to supply cattle to Meyer to sell. The LLC Agreement provided that the sole purpose of PNB was to market, distribute, and sell beef (the "PNB Business"). It also contained an integration clause. All three agreements addressed competitive activities – the Purchase Agreement provided that Respondents could not own or operate a competing business. These restrictive covenants were identified as "essential to protect the business and the goodwill of the Company" and were to immediately terminate if Respondents terminated the Output and Supply Agreement or the LLC Agreement. The Output and Supply Agreement granted Meyer and its subsidiaries exclusive rights to purchase qualifying cattle from the Respondent Companies, while the LLC Agreement required Meyer to use commercially reasonable efforts to promote and expand the PNB Business and subjected the parties' rights to engage in other activities to the restrictive covenants in the Purchase Agreement.

Respondents purported to terminate the Output and Supply Agreement in July 2012 and filed suit against Meyer and PNB in Oklahoma, alleging breaches of contractual and fiduciary duties. The Oklahoma court ordered termination of the exclusive supply and purchase obligations of the parties under the Output and Supply Agreement. Although the court order stated that it did not affect any rights the parties had against each other under the restrictive covenants in the Output and Supply Agreement or other contracts, respondents argued that they were no longer bound by these covenants.

Before the court was Meyer's motion for the judicial dissolution of PNB. Meyer asserted an inability to continue PNB's business in accordance with the parties' original agreement, arguing that the purpose of PNB was not only to sell beef but also to partner exclusively with respondents in a joint venture. Meyer further argued that because the Output and Supply Agreement was no longer effective, respondents believed they were free to compete against Meyer, making PNB's business impracticable. Respondents opposed dissolution based on concerns about prejudicing recovery in the ongoing

Oklahoma litigation and asserted that the business remained reasonably practicable. They further argued that if the parties had wanted dissolution, there was a contractual mechanism they could have used to effectuate it.

The court began its analysis by noting that operational deadlock was not an issue because of the authority granted to Meyer as managing member, characterizing the dispute as one over PNB's purpose. Respondents argued for a broad characterization of PNB's purpose, whereas Meyer argued for a contextual interpretation based on the various non-compete and mutual obligations in the three relevant agreements. The court agreed with Meyer, interpreting precedent as providing that the purpose clause is of primary importance, but that other evidence of purpose may be helpful as long as the court is not asked to engage in speculation. It found that, despite the integration clause in the LLC Agreement, the entirety of the parties' agreement demonstrated that PNB was not intended to be a business where Meyer ran all of the operations and distributed profits to respondents as passive members with an incidental supply contract. Rather, the non-compete covenants in the Purchase Agreement demonstrated the importance of the parties' supply arrangement.

The court next considered whether it was no longer reasonably practicable to operate PNB in accordance with its purpose. Considering that the purpose of PNB was to market and sell beef supplied by the Respondent Companies according to Meyer's specifications, the court concluded that it was no longer reasonably practicable to operate PNB. Although there was no operational deadlock and PNB was profitable the prior year, it found that PNB could not achieve its purpose when respondents did not believe restrictive covenants applied to them and the Output and Supply Agreement had been terminated. Meyer had thus made a prima facia case for dissolution.

The court noted that the contractual dissolution mechanism did not affect its decision. It found that respondents had not agreed to dissolution, then discussed whether the LLC agreement forbade Meyer from filing an action for dissolution. Although the LLC agreement provided that "the Managing Member shall have no authority . . . to cause the Company to undertake or engage in . . . the dissolution" of PNB, Meyer argued that the contract could not trump the LLC Act and interpreted the LLC agreement as allowing Meyer to petition the court for judicial dissolution but not to directly take steps to dissolve PNB. The court accepted this reading and cited authority counseling against strict interpretation of an LLC agreement where the result would be inequitable.

Lastly, the court noted that the equities weighed in favor of dissolution, finding that PNB's dissolution would not materially prejudice the Oklahoma litigation and that the record did not suggest dissolution would affect respondents' ability to collect damages from Meyer in that litigation.

24. *de Vries v. Diamanté del Mar, L.L.C.*, C.A. No. 9782-ML (Del. Ch. June 3, 2015) (M.C. LeGrow)

An LLC's operating agreement required the managing member to prepare and provide quarterly and annual reports to the other members, an obligation that the managing

member ignored for the past five years. During that time period, the managing member, in settling a breach of contract claim (the "Settlement"), caused the LLC to surrender its only asset to satisfy a debt that the managing member had personally guaranteed and that was worth only a fraction of the value of the asset. The asset transfer extinguished the personal guarantee. Unaware of the asset transfer, two members of the LLC (plaintiffs in this case) attempted to inspect the LLC's books and records to determine the value of the members' investment and to investigate possible mismanagement. The LLC permitted the members to inspect the LLC's books and records but withheld privileged documents that would have revealed information regarding the asset transfer. Plaintiffs moved to compel the privileged documents' production under the fiduciary exception to attorney-client privilege, and the master recommended that the Court of Chancery grant the motion in part.

In analyzing the application of the fiduciary exception to attorney-client privilege, which exception "attempts to strike a balance between the privilege's purpose of encouraging open communication between counsel and client, and the right of a stockholder to understand what advice was given to fiduciaries who are charged with breaching their duties," the master noted that the Delaware Supreme Court held that the "good cause" test adopted by the Fifth Circuit Court of Appeals in *Garner v. Wolfinbarger* may apply in books and records actions. The master stated that the court must first determine that the records at issue are "necessary and essential" to the stockholder's stated purpose for inspection. Then, if the court answers that inquiry affirmatively, it should undertake the *Garner* "good cause" analysis. The necessary and essential test is satisfied if the document "addresses the crux of the shareholder's purpose, and if the essential information the document contains is unavailable from any other source." The master found that the documents relating to the negotiation of the Settlement and the transfer of the LLC's only asset were necessary and essential to plaintiffs' stated purpose for inspection.

The master then turned to the application of the *Garner* "good cause" test, noting that the Court of Chancery generally viewed the following factors of the test as the most important: the nature of the claim, whether the claim was obviously colorable, the apparent necessity or desirability of the shareholder having the information, the availability of the information from other sources and the extent to which the information requested was identified as opposed to whether the shareholder was blindly fishing for information. The master held that the *Garner* factors were either irrelevant, neutral in their application or favored the application of the fiduciary exception for documents created after the Settlement. Therefore, she recommended that the Court of Chancery grant plaintiffs' motion to compel in part and order the LLC to allow plaintiffs to inspect documents on the privilege log created after the Settlement but not created in connection with this litigation.

25. *AM General Holdings LLC v. The Renco Group, Inc.,* C.A. No 7639-VCN (Del. Ch. May 29, 2015) (V.C. Noble)

In this decision, defendant, The Renco Group, Inc., asked the court to reconsider its appointment of Valuation Research Corporation ("VRC") as an appraiser of plaintiff, AM General Holdings LLC. The court denied defendant's motion to reconsider.

The court, under the evident partiality standard, may invalidate an arbitrator or appraiser if the arbitrator or appraiser failed "to disclose a substantial personal or financial relationship with a party, a party's agent or a party's attorney that a reasonable person would conclude was powerfully suggestive of bias." Defendant claimed that VRC was conflicted and thus disqualified from acting as appraiser in this case because VRC and plaintiff's counsel, Paul, Weiss, Rifkind, Wharton & Garrison LLP ("Paul Weiss"), worked for mutual clients over the past five years. In addition, defendant asserted that VRC could not serve as an appraiser because plaintiff did not disclose VRC and Paul Weiss' relationship before the court appointed VRC as an appraiser. The court rejected the defendant's argument, reasoning that the alleged conflict was "not so serious as to be disqualifying," Paul Weiss did not recommend, select, hire, retain, or pay VRC in any of the instances where Paul Weiss and VRC had mutual clients, and most importantly, the relationship was disclosed before VRC began its work. The court noted that it should not interfere with an appraiser's judgment of his or her own ability to serve after the appraiser disclosed the possible conflict. Based on the forgoing, the court denied defendant's request to remove VRC as an appraiser.

26. *In re Knowledge Crossing LLC*, C.A. No. 10383-VCG (Del. Ch. May 29, 2015) (V.C. Glasscock)

Petitioner brought an action to dissolve Knowledge Crossing LLC ("KX"), arguing that its board was deadlocked as to certain matters, including dissolution. Before the court was respondents' motion to dismiss, seeking dismissal under the *McWane* doctrine in favor of a first-filed arbitration in California. Petitioner contended *McWane* did not apply because the "same issues" were not involved—the California arbitrator did not have jurisdiction over the issue of dissolution and there was no risk of inconsistent judgments. Respondents contended that the arbitrator's decision would bear on the entity's assets, as well as the validity of the operating agreement, and thus that there was substantial overlap, presenting a risk of inconsistent judgments.

Because the issue of the proper scope of arbitration was pending before the arbitrator, the court temporarily stayed its consideration of the motion to dismiss pending the determination of this issue. The parties agreed that a short-term delay in the proceedings posed no threat to KX.

27. *CanCan Dev., LLC v. Manno,* C.A. No. 6429-VCL (Del. Ch. May 27, 2015) (V.C. Laster)

This decision after a trial involved an LLC formed to pursue a casino venture (the "Project") by Sandra Manno, who managed the LLC during most relevant times and was

a defendant in this case ("Manno"), and a father ("Senior") and son ("Junior" and together with Senior, the "Investors") who invested in the LLC and were plaintiffs in the case together with the LLC itself. Among other facts that the court found were proven by a preponderance of the evidence at trial, the court found that Manno hired relatives and friends at generous salaries to manage the Project (including her sister who did not produce any work product, a friend who was paid by the LLC but worked solely on writing a screenplay of Manno's life, and a convicted felon), that she improperly hired a full-time driver for herself, that she periodically increased her salary without justification, that she improperly billed all of her living expenses, including meals and entertainment, to the LLC and that she on more than one occasion asked the Investors to contribute more capital to the LLC because it kept running out of money due to her mismanagement. The Investors ultimately had Manno removed as manager of the LLC and a judgment confirming such removal was entered by the Delaware Court of Chancery prior to this decision.

The court first addressed claims by the Investors and the LLC that Manno breached her fiduciary duties to the LLC, although the court noted that these claims belonged to the LLC and not the Investors. The court found that Manno owed fiduciary duties as manager of the LLC. In citing to prior cases, the court noted that the essence of a duty of loyalty claim is the assertion that a corporate officer or director has misused power over company property to benefit herself rather than to advance a corporate purpose and that a fiduciary must always act in a good faith effort to advance the interests of her beneficiary. The court further indicated that the duty of loyalty prohibits a fiduciary from misappropriating assets under her management. With respect to this standard, the court stated that self-interested compensation decisions and decisions by interested fiduciaries to reimburse their own expenses or provide themselves with company benefits are subject to entire fairness review. In this regard, the court stated that if fiduciaries divert company assets to themselves for non-corporate purposes, they are liable for the amounts diverted. Based on the lack of justification for Manno's compensation and reimbursed expenses in this case, including many expenses that lacked a documented business purpose, the court found that Manno was liable for a large part, although not all, of her compensation and expense reimbursements. Although Manno argued that another employee approved her increases in compensation, the court found that Manno's relationship with such employee was sufficiently close so that he could not be regarded as independent and that he simply rubber stamped the compensation without exercising any business judgment. As a result, the court found that such approval did not insulate Manno's unilateral decision from entire fairness review. The court then turned to the compensation Manno paid the employees that were her relatives and also applied entire fairness to their compensation, noting that family ties raise doubts about a fiduciary's independence. Based on the facts in this case, the court found that Manno was also liable for a portion of this compensation.

The court next discussed the Investors' claim that Manno used funds of the LLC to pursue projects that did not benefit the LLC, including an online gaming business and other casino ventures, a food and wine festival, a screenplay for a movie about her life and a personal move back to New Jersey. With respect to all of these expenses, the court found in favor of the Investors. However, the Investors also argued that Manno

excessively spent LLC funds on limousines, hotels, meals and flights. The court observed that these expenses would ordinarily be subject to the business judgment rule, but in this case, many of the expenses related to the interested transactions identified above. As a result, the court found that Manno bore the burden at trial to "establish the purpose, amount, and propriety of the disbursements." The court found that Manno was liable for these expenses to the extent she could not demonstrate a documented business purpose.

The court then addressed the Investors' claim that certain expenses constituted waste, which consisted of expenditures on a luxury box that she used with friends that she hired as employees but rarely to entertain business guests, compensation to such friends and expenditures for liquor and cigars. The court noted that waste was one means of establishing a breach of the duty of loyalty's subsidiary element of good faith. In applying the business judgment rule, the court mentioned that it would infer bad faith and a breach of duty when a decision lacks any rationally conceivable basis and that the waste test is one of establishing irrational, bad faith conduct. In citing to case law, the court found that to establish waste, a plaintiff must prove that a decision was so out of whack that no business person of ordinary, sound judgment would have made it. Because the court determined that Manno lied about how she used the luxury box and never used it for business guests, the court found that she was liable for waste for the costs of the luxury box. The court also found Manno liable for waste for the compensation paid to her friend, who was a convicted felon, and indicated that no rational person would hire a convicted felon to work in a highly regulated casino industry. However, the court found that Manno was protected by the business judgment rule for hiring a friend that had relevant experience and for expenses on cigars and liquor as it appeared that she sent them to potential investors, customers and suppliers and plaintiffs could not prove that she incurred these expenses for her personal benefit.

Plaintiffs also sought to hold Manno Enterprises, an entity owned by Manno, liable in what the court characterized as a reverse veil-piercing claim because they argued that Manno Enterprises, an entity, was liable for acts of an individual. The court noted that reverse pierce claims implicate different policies and require a different analytical framework from a more conventional veil-piercing claim and because the claim was not properly presented, the court found that the claim failed.

Lastly, the court turned to Manno's counterclaims. She first claimed that she was promised a lucrative consulting agreement and that she was unfairly diluted, in both cases, prior to entering into the LLC agreement of the LLC. The court held that the LLC agreement was a fully integrated agreement and that it stated that any consulting agreement would need to be in writing and approved by a supermajority of the members and that it also stated the ownership interests of the members of the LLC. For these reasons, the court found that the LLC agreement controlled and rejected Manno's claims. Manno then claimed that she was diluted from capital calls after the effectiveness of the LLC agreement. The court found that the capital calls complied with the LLC agreement. However, the court indicated that when Junior gained control over the LLC, he owed fiduciary duties to the entity and that the capital calls which resulted in increasing his interest constituted self-dealing transactions subject to entire fairness review

notwithstanding the facts that the capital calls were made pro rata and pursuant to the terms of the LLC agreement. After finding that the capital calls were necessary for the LLC to avoid immediate failure, made at times when financing on comparable terms was not available, and that the capital calls were priced appropriately, the court found that the capital calls satisfied the fair dealing/fair price requirements of entire fairness review. Manno then claimed that Junior usurped an LLC opportunity by having an entity he owned purchase property that the LLC had previously considered purchasing. The court held that a fiduciary violates his duty of loyalty by usurping a company opportunity when (i) the entity is financially able to undertake the opportunity, (ii) the opportunity falls within the line of the company's business, (iii) the entity has an interest or a reasonable expectancy in the opportunity and (iv) the fiduciary's interests conflict with those of the entity. The court found that the LLC lacked the resources to purchase the property and thus Junior could not have usurped this opportunity.

Finally, Manno claimed that Junior breached his fiduciary duties by dissolving the LLC and selling its assets to an entity he controlled. The court cited to prior case law in noting that a fiduciary can satisfy the entire fairness standard in a transaction where an interest holder receives nothing if the fiduciary proves that there was no future for the business and no better alternative for the interest holder. Based on the facts in this case, including that Junior shopped around for investors and that Manno's interest had no value because it was subordinate to the return of the Investors' capital and therefore effectively "under water," the court found that Junior did not breach his fiduciary duties.

28. *In re Carlisle Etcetera LLC,* C.A. No. 10280-VCL (Del. Ch. April 30, 2015) (V.C. Laster)

One of two members of a Delaware LLC assigned its interests to its subsidiary. The management board of the LLC eventually deadlocked and the assignee petitioned the court to dissolve the LLC. The other of the original two members of the LLC moved to dismiss on grounds that the assignee was not a member and, thus, the assignee lacked standing to petition for statutory dissolution of the LLC under Section 18-802 of the Delaware LLC Act. The assignor joined the assignee as a co-petitioner.

The court first addressed whether the assignor or assignee had standing to seeking dissolution under Section 18-802 of the Delaware LLC Act. The court noted that Section 18-802 permits members and managers of an LLC to seek statutory dissolution. Neither the assignor nor the assignee claimed to be a manager; however, both claimed to be members. The court noted that because the LLC agreement was silent on assignments, the interest was freely assignable. The court then found that the assignor lost its status as a member of the LLC when it assigned its all of its interests in the LLC to its subsidiary because Section 18-702(b)(3) of the LLC Act states that, unless otherwise provided in the LLC Agreement (which, in this case, was silent on assignment), "a member ceases to be a member . . . upon assignment of all of the member's limited liability company interest." The court also analyzed whether the assignee was a member of the LLC, finding that the assignee did not automatically become a member upon the assignment of the interest. The court cited to Section 18-702(b)(1) of the LLC Act, which provides that, unless otherwise provided in an LLC Agreement, an "assignment of a limited liability company

interest does not entitle the assignee to become . . . a member." The LLC Agreement did not otherwise provide and, therefore, the court found that the assignor's transfer of the interest to its subsidiary made the subsidiary as assignee, not a member. The court also noted that the LLC Agreement did not give assignees the right to seek statutory dissolution.

The court then turned to petitioners' allegations that the assignee became a *de facto* member by consent of the parties. The assignee claimed that, under Section 18-301(b)(1) of the Delaware LLC Act, the assignee became a member once its status was reflected in the books of the LLC. The assignee pointed to tax forms and a draft amended and restated LLC agreement that had never been adopted as "records" of the LLC that identified the assignee as a member. However, the court found the assignee's jump to Section 18-301 too hasty. The court reviewed Section 18-301(b), which states that an assignee may become a member as provided in Section 18-704(a). The court drew a distinction between the admission of a member and the time at which the admission takes effect and focused here on whether the assignee had been admitted as permitted under Section 18-704(a). Section 18-704(a) identifies two possibilities for a permitted admission of an assignee—either as provided in the LLC agreement or, unless otherwise provided in the LLC agreement, upon the affirmative vote or written consent of all members. The LLC agreement was silent on admission of assignees as members and the court found that "affirmative vote or written consent" meant a type of formal action of members contemplated in Section 18-302. No such formal action was pled in this case and, therefore, the court found that there was never a permitted admission of the assignee as a member of the LLC. Because the assignee was not a member, it could not seek judicial dissolution under Section 18-802.

However, the court continued its analysis. It refused to grant the motion to dismiss on the grounds that neither the assignor nor the assignee could seek statutory dissolution under Section 18-802. The court found that, under the facts of this case, the assignee had standing to seek dissolution in equity. The court stated:

> For Section 18-802 to provide the exclusive method of dissolving an LLC, it would . . . divest this court of a significant aspect of its traditional equitable jurisdiction. Section 18-802 does not state that it establishes an exclusive means to obtain dissolution, nor does it contain language overriding this court's equitable authority. To the contrary, the LLC Act elsewhere recognizes that equity backstops the LLC structure by providing generally that "the rules of law and equity" shall govern in "any case not provided for in this chapter." 6 *Del. C.* § 18-1104.

The court further noted that (i) an LLC agreement is not "an exclusively private contract among its members precisely because the LLC has powers that only the State of Delaware can confer", (ii) "dissolution is not a purely private affair" and, therefore, (iii) Delaware retains an interest in having the court available to hear a dissolution petition of an LLC "where equity demands". Therefore, because the assignee had standing to seek dissolution of the LLC in equity, the court denied the motion to dismiss.

29. *Hampton v. Turner*, C.A. No. 8963-VCN (Del. Ch. April 29, 2015) (V.C. Noble)

Plaintiffs David Hampton, Sorin Brull and Richard Szymke co-founded defendant T4Analytics LLC ("T4" or the "Company"). Defendant Michael Turner, another co-founder of T4, contributed $220,000 to the Company and raised another $829,000 from T4's non-founding members. Hampton, Brull and Szymke made no capital contributions, but along with Turner each received a 23.54% interest in T4.

Plaintiffs sought judicial dissolution of T4 pursuant to § 18-801 or § 18-802 of the Delaware LLC Act. The Company responded by exercising an option to purchase plaintiffs' units under Section 5.3 of T4's LLC agreement (the "Agreement"), which permitted it to purchase the units of a member who seeks dissolution under § 18-801 for the "Fair Market Value" of the member's units. Section 5.4 of the Agreement provided that Fair Market Value was to be determined by an appraiser. The parties mutually selected an appraiser, who determined T4's Fair Market Value to be $1.886 million. The appraiser determined that he could not make a final determination of the value of plaintiffs' units, however, because of the parties' conflicting interpretations of the Agreement. Subsequently, T4 issued each of plaintiffs' checks for $197,089, purporting to close on its acquisition of their membership interests. T4 arrived at this figure by deducting $1.049 million (the amount of Turner's and the non-founding members' capital contributions) from $1.886 million and multiplying the difference, $837,000, by 23.54%.

Defendants then moved for summary judgment, arguing that plaintiffs lacked standing to pursue dissolution because they were no longer members and that they paid plaintiffs the fair market value of their units under Section 4.3 of the Agreement, which they maintained was the only provision explicitly addressing distributions and which included a waterfall priority. Plaintiffs, on the other hand, contended that Section 5.4 required T4 to pay them 23.54% of $1.886 million, and therefore that T4 had not purchased their membership interests. They argued that they were each entitled to $443,964 because Section 4.3 was not applicable to membership repurchases under Section 5.4.

The court began by looking to Section 5.3 of the Agreement, which referred to Section 5.4 for more detail on payment. Because Section 5.4 mentioned an arms-length sale and an appraisal, and not a pro rata division or the waterfall provision of Section 4.3, the court found that the section seemed to consider net assets, not capital contributions. Bolstering the court's conclusion that Section 4.3 did not apply was that it referred to distributions of excess cash, assuming that T4 had to maintain cash for business needs, and that neither Section 5.3 nor 5.4 referenced Section 4.3.

The court held that under the plain meaning of Sections 5.3 and 5.4, T4 could buy plaintiffs' portion of T4's appraised value without taking capital contributions into account. It found that this conclusion was not inequitable considering that Hampton and Brull invented the technology key to T4's business, that the Agreement distinguished between founding members and other members and that defendants played a role in drafting the contract. It further reasoned that when Turner and the non-founding members made capital contributions to T4, they no longer fully owned these assets. Had they wanted to protect their rights to their capital contributions upon termination of their

relationship with the Company, they could have done so by referring to the distribution waterfall in describing the purchase option. In sum, the court found no reason to disrupt the objective language used in the Agreement.

Finally, the court denied defendants' motion for summary judgment on the grounds that plaintiffs lacked standing. There was an unresolved issue as to whether defendants were obligated to pay the purchase price pursuant to the court's interpretation of the purchase option or if they could choose whether to leave plaintiffs with their units. The court found that until this issue was resolved, the purchase of plaintiffs' units could not be completed and thus plaintiffs would remain members with standing to seek dissolution.

30. *CSH Theatres, LLC v. Nederlander of San Francisco Associates*, C.A. No. 9380-VCP (Del. Ch. April 21, 2015) (V.C. Parsons)

This case involved claims arising from an oral agreement to renew a long-running lease of a theater to a Delaware limited liability company, Shorenstein Hays-Nederlander Theatres LLC (the "Company"). The Company was in the business of providing venues for live performances and was equally owned by its two members, Nederlander of San Francisco Associates ("Nederlander") and CSH Theatres, LLC ("CSH"). A dispute between the members arose when a theater (the "Curran") operated by the Company was offered for sale. The indirect owner of CSH ("Hays") formed an entity to purchase the Curran, but Nederlander would only consent to the purchase if the Company was granted a long-term lease on the same terms and conditions as the Company's existing lease. The parties allegedly orally agreed to lease terms for the Curran, however, were unable to reduce the terms of this agreement to a written contract and Hays eventually refused to honor the terms of the oral lease agreement unless CSH and its board representatives were given control of the Company. Nederlander accused CSH of breaching the limited liability company agreement of the Company (the "LLC Agreement") as a result of CSH (and its members) directly competing with the Company, misappropriating confidential Company information and using the Curran as a means of seizing control of the Company. Plaintiff argued that the actions of defendant violated certain non-compete, corporate opportunity and conflict of interest provisions of the LLC Agreement. Defendant filed a motion to dismiss, which the court denied because the terms of the relevant provisions of the LLC Agreement were arguably ambiguous.

In reaching its holding, the court focused its attention on the defined terms used in those non-compete, corporate opportunity and conflict of interest provisions of the LLC Agreement. The definition of "Member" included Nederlander and CSH and their "Permitted Transferees", which included any "Affiliate" of Nederlander or CSH. "Affiliate" included any direct or indirect controller of Nederlander or CSH. Plaintiff argued that any time Nederlander or CSH was used in the LLC Agreement, it included such member's affiliates, which in this case would mean that Hays, as indirect controller of CSH, was subject to the provisions of the LLC Agreement. Defendants countered that the definition of "Member" only included "Permitted Transferees" to indicate that future transferees of a member's interest in the Company would be subject to the LLC Agreement and was therefore intended to mean the "Member or Permitted Transferee," not both. Defendants also pointed to provisions in the LLC Agreement that included

"any Affiliate thereof" after Nederlander or CSH as proof that references to Nederlander and CSH should not be given the expansive definition sought by plaintiffs.

At the motion to dismiss stage, any ambiguity in a contract must be resolved in favor of the nonmoving party. The court therefore concluded that because the LLC Agreement, read literally, defined Nederlander and CSH to include their affiliates, Hays could arguably be subject to the terms of the LLC Agreement and may therefore have breached the LLC Agreement. The motion to dismiss was denied with respect to these claims.

31. *In re: El Paso Pipeline Partners, L.P. Derivative Litigation*, C.A. No. 7141-VCL (Del. Ch. April 20, 2015) (V.C. Laster)

In this post-trial opinion, the court addressed plaintiffs' challenge to a "dropdown" transaction whereby the parent corporation in a master limited partnership structure, El Paso Corporation ("El Paso Parent"), sold interests in two of its subsidiaries to El Paso Pipeline Partners, L.P. (the "MLP"). The court found that the MLP's general partner, in engaging in the transaction with El Paso Parent, had violated the MLP's limited partnership agreement. The court held that members of a committee of independent members of the general partner's board (the "Committee") who approved the transaction via "special approval" failed to form the requisite subjective belief that the dropdown transaction was in the best interests of the MLP.

Plaintiffs originally challenged two dropdown transactions, which the court referred to as the "Spring Dropdown" and the "Fall Dropdown." The court previously had granted defendants' motion for summary judgment as to the Spring Dropdown and partially denied defendants' motion for summary judgment as to the Fall Dropdown, finding that questions of material fact existed requiring a trial as to the state of mind of the members of the Committee when approving the Fall Dropdown. The court noted that it expected that the Committee members and their financial advisor would provide a credible account of how they evaluated the Fall Dropdown, negotiated with El Paso Parent and ultimately determined that the transaction was in the best interests of the MLP. However, that is not what the court found. Rather, the court found that the Committee members went against their better judgment and did what El Paso Parent wanted and not what they believed was in the best interests of the MLP. The court rejected trial testimony of the Committee members that they believed the transaction was in the best interests of the MLP, finding that the testimony was rehearsed, not credible, and inconsistent with their contemporaneous emails and deposition testimony. Specifically, the court pointed to various internal assessments by Committee members suggesting they believed that the actual value of the assets was lower than the price proposed by El Paso Parent – and accepted by the Committee – and also that it was not in the best interest of the MLP to acquire additional interests in the subsidiary, which related to the importation of liquefied natural gas, a market that appeared to be in decline. Consequently, the court determined that the MLP had paid $171 million more for one of the assets that it acquired than it would have if the general partner had not breached the limited partnership agreement.

The court also expressed concern regarding the process followed, and the work product generated, by the Committee's banker. Specifically, the court noted that the banker met

with El Paso Parent's management before meeting with the Committee, did not emphasize certain relevant information in their presentation and failed either to follow the same approach in the Fall Dropdown as in the Spring Dropdown or bring the inconsistency to the Committee's attention, all in an effort to make the Spring Dropdown look as attractive as possible. The court noted that the banker's entire fee was contingent on delivering a fairness opinion, suggesting that the banker did what it could to justify the Fall Dropdown, get to closing and collect its contingent fee.

The court also found that the Committee was unduly focused on accretion of distributable cash to the holders of the common units, when they should have been focused on carrying out their known contractual obligation to determine whether the Fall Dropdown was in the best interests of the MLP. In its prior opinion, the court had noted that the contractual standard under the limited partnership agreement was whether a proposed transaction was in the best interests of the MLP, which meant that the Committee could consider constituencies including employees, creditors, suppliers, customers, the general partner, IDR holders and "of course" the limited partners. In this post-trial opinion, however, the court made clear that in considering the interests of the limited partners, it was not sufficient for the Committee members to focus only on whether a proposed transaction was accretive to cash distributions. Rather, the Committee and its banker should have engaged in a rigorous valuation analysis that took into account prior transactions involving the same assets. The court noted that the Fall Dropdown related to two separate assets that the Committee should have evaluated separately, and had it done so, it would have realized that it was paying more than it agreed to pay for one of the assets when it was the only asset in the proposed transaction.

Based on these findings, the court held that the Committee members did not conclude that the Fall Dropdown was "in the best interests of [the MLP]" as required by the MLP's limited partnership agreement and, therefore, the MLP's general partner breached the MLP's limited partnership agreement by engaging in the Fall Dropdown. The court awarded damages in the amount that the MLP paid for the interest acquired in the Fall Dropdown that exceeded what it would have paid had the general partner not breached the MLP's limited partnership agreement.

32. *The Renco Group, Inc. v. MacAndrews AMG Holdings LLC*, C.A. No 7668-VCN (Del. Ch. April 20, 2015) (V.C. Noble)

In its subsequent decision, the court addressed plaintiff's request for a certification of an interlocutory appeal of the court's earlier decision to dismiss plaintiff's fiduciary duty claims against defendants. While the court held that plaintiff met the substantial issue and legal right requirements of a certification of interlocutory appeal, plaintiff did not satisfy one of the factors enumerated in Supreme Court Rule 42(b). Plaintiff argued that even if plaintiff's fiduciary duty claims against defendant were properly dismissed, the court still must decide plaintiff's aiding and abetting claims against third-party defendants based on those fiduciary duties. The court denied plaintiff's interlocutory appeal, reasoning that interlocutory appeals are disfavored when they are not case dispositive.

33. *Utilipath LLC v. Hayes*, C.A. No. 9922-VCP (Del. Ch. April 15, 2015) (V.C. Parsons)

Defendants Baxter Hayes, Jr., Baxter Hayes, III and Jarrod Hayes, the sole members of Utilipath, LLC, a North Carolina limited liability company ("Old Utilipath"), transferred all of their membership interests in Old Utilipath to defendant Utilipath Holdings, Inc., a North Carolina corporation ("Holdings"). Old Utilipath then merged with Utilipath, LLC, a Delaware limited liability company ("Utilipath"), making Utilipath a wholly-owned subsidiary of Holdings. Subsequently, defendants caused Holdings to sell its membership units in Utilipath to Utilipath via a Redemption Agreement (the "Agreement"). The Agreement provided that the purchase price could be adjusted post-closing if Utilipath's net working capital ("NWC") fell below a certain amount. If a dispute arose as to the calculation of the NWC, an alternative dispute resolution ("ADR") provision in the Agreement provided that the parties would select an independent accounting firm to perform the calculation. The ADR provision also stipulated that it was subject to the Federal Arbitration Act (the "FAA").

When Utilipath provided defendants with its calculation of the closing working capital, defendants objected. In this action, Utilipath sought to compel enforcement of the Agreement as it related to the NWC adjustment. Defendants moved to dismiss on procedural and substantive grounds. They argued, among other things, that the action should be dismissed under the *McWane* doctrine, on the grounds that the Agreement was already being litigated in a first-filed action in the Eastern District of Pennsylvania, and that the ADR provision in the Agreement was an unenforceable "agreement to agree" that did not provide an adequate means of selecting an arbitrator.

The court denied defendants' motion to dismiss under the *McWane* doctrine, noting that the doctrine is a default rule of common law which parties may displace by contract. The parties agreed in the Agreement that venue in any Delaware court would be proper and waived any objection that any such court was an improper or inconvenient forum to resolve disputes. The fact that this forum selection clause did not provide for exclusive jurisdiction in Delaware courts did not change the fact that venue was proper in Delaware. However, the court declined to decide whether the dispute was arbitrable at this stage of the litigation.

The court also denied defendant's motion to dismiss on the grounds that the arbitration provision was unenforceable. The Agreement did not lack an essential term relating to the selection of an arbitrator, since it referenced the FAA. The FAA provides that if the parties cannot agree on an arbitrator, a court shall designate an arbitrator. Thus, if the parties could not agree on an independent accounting firm to calculate the NWC, the court could designate one.

34. *3850 & 3860 Colonial Blvd., LLC v. Griffin*, C.A. No. 9575-VCN (Del. Ch. March 30, 2015) (V.C. Noble)

This case involved the arbitrability of a dispute between a Delaware LLC and a Delaware corporation. Prior to the litigation's commencement, defendant Christopher E. Griffin ("Griffin") executed a conversion of Rubicon Media, LLC ("Rubicon LLC") into a

corporation, Rubicon Media, Inc. ("Rubicon Inc."). Plaintiff filed an action in the Court of Chancery, consistent with the certificate of incorporation of defendant Rubicon Inc., claiming that Griffin breached his fiduciary duties when he effectuated the recapitalization of Rubicon LLC. Defendants sought to dismiss the complaint for lack of subject matter jurisdiction as the parties agreed to arbitrate in the operating agreement of Rubicon LLC. Before the court was plaintiff's application for certification of an interlocutory appeal to the Delaware Supreme Court of the court's February 26, 2015 ruling to stay the proceedings pending arbitration.

Rubicon LLC's operating agreement provided that any dispute arising under or relating to the agreement would go through mediation followed by arbitration. Rubicon Inc.'s certificate of incorporation stated that the Court of Chancery was the exclusive forum for any stockholder fiduciary duty litigation. The conduct at issue in this litigation occurred during the existence of Rubicon LLC. Pursuant to Supreme Court Rule 42, to certify an interlocutory appeal, the court must be convinced that its earlier decision determined a substantial issue and established a legal right. To satisfy this requirement, the issue must go to the merits of the case. The appellant must also fulfill one of the requirements enumerated in Supreme Court Rule 42(b).

Because the arbitrability of a matter does not go to the actual merits of plaintiff's fiduciary duty claim, the court held that plaintiff did not satisfy the substantial issue and legal right requirements of Supreme Court Rule 42. The court also rejected plaintiff's attempt to satisfy one of the criteria listed in Supreme Court Rule 42(b). First, the court held that plaintiff did not present a novel question of law because while this case is the first application of a legal standard, that fact alone does not make it a novel question of law. Second, the court held that its earlier decision did not conflict with other decisions of the Court of Chancery because whether a later contract displaces a prior contract depends upon the facts and circumstances—some later contracts displace prior contracts and some do not displace prior contracts. Therefore, the court denied plaintiff's application for certification of an interlocutory appeal.

35. *Smashburger Master LLC v. Prokupek*, C.A. No. 9898-VCN (Del. Ch. March 27, 2015) (V.C. Noble)

Defendant, former Chairman and CEO of plaintiff Smashburger Master LLC ("Smashburger"), was granted restricted equity of Smashburger as a term of employment, most of which would not vest unless Smashburger met certain "performance hurdles". Plaintiff terminated him and redeemed his vested units pursuant to its LLC Agreement (the "Agreement"). The parties disagreed about plaintiff's valuation of defendant's units, disputing whether Smashburger achieved the performance hurdles and whether defendant's units were subject to a minority discount. They agreed that an independent firm would value the units and selected a Special Master to assist with the valuation. Plaintiff then moved to stay discovery and moved to dismiss defendant's counterclaims or, alternatively, to stay or bifurcate the counterclaims. In essence, plaintiff's motions sought a determination of the procedures to be employed to decide the parties' disputes relating to the valuation.

The court stayed its consideration of defendant's counterclaims, and thus its motion to dismiss, deferring to the independent firm to resolve in the first instance issues connected with the valuation. The court also stayed consideration of the motion to stay discovery, finding that the independent firm should first determine what information was necessary or helpful for its valuation work. Although the court acknowledged the potential inefficiency of having the independent firm make detailed findings regarding valuation, only to have those findings modified or overturned by judicial review, it emphasized the importance of not interfering with the valuation process chosen by the parties in the Agreement. It also found that the independent firm should consult the Special Master first, rather than the court, if it had difficulty resolving any of the legal or accounting issues related to the valuation.

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