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2009 SUPPLEMENT TO
CUMULATIVE SURVEY OF DELAWARE CASE LAW
RELATING TO
ALTERNATIVE ENTITIES¹

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1. *Jakks Pacific, Inc. v. THQ/Jakks Pacific, LLC and THQ, Inc.*, C.A. No. 4295-VCL (Del. Ch. May 6, 2009)

Plaintiff, a member of a Delaware LLC (the “Company”), brought an action to inspect the Company’s books and records pursuant to Section 18-305 of the LLC Act. The Company was a joint venture formed by the plaintiff and defendant THQ, Inc. (“THQ”) to develop and sell wrestling-based video games pursuant to a license from World Wrestling Entertainment (“WWE”). The WWE license would expire on December 31, 2009; however, the Company had an option to extend the term of the license agreement for a five-year period if the Company were not in default under the license agreement. Pursuant to the Company’s LLC agreement, THQ operated the Company on a day-to-day basis and plaintiff was entitled to a guaranteed preferred return based on an income stream related to the license agreement contributed by plaintiff to the Company. The preferred return was based upon historical sales data such that it would approximate 49% of the profits of the Company during the distribution period. Initially, the percentage agreed upon was 10% for the period from October 1999 to June 30, 2006. The current distribution period began July 1, 2006 and ended December 31, 2009. The parties had been unable to establish a preferred return rate for the current distribution period and therefore the issue was presented to an arbitrator as required under the Company’s LLC Agreement.

Although extensive discovery was taken in connection with the arbitration, in March, 2008, plaintiff made a demand for financial documents, which the Company complied with. Subsequently, plaintiff made a second demand for a broad range of documents relating to the Company and THQ. THQ responded that plaintiff’s request was overly broad but that THQ was willing to make a limited production, subject to plaintiff’s agreement to certain conditions. Plaintiff refused the offer and commenced this action to enforce its rights under Section 18-305 of the LLC Act.

Plaintiff offered three purposes for which it needed the demanded documents: (1) to aid it in negotiating the preferred return for the next distribution period, (2) to value its interest in the Company, and (3) to investigate alleged mismanagement and wrongdoing by THQ in managing the affairs of the Company. The court ruled in favor of the Company, stating that plaintiff had failed to demonstrate a proper purpose for its demand. The court stated that, under Section 18-305 of the LLC Act, a member must first establish, by a preponderance of the evidence, the existence of a proper purpose for the inspection sought. Additionally, the court stated that “such a purpose cannot be proper in the abstract, but must be reasonably related to the specific interests of the member making the demand.”

The court went on to analyze separately each purpose offered by plaintiff. With respect to the first purpose offered by plaintiff, that it needed the documents to aid it in negotiating the preferred return for the next distribution period, the court reasoned that due to the current relationship between plaintiff and WWE and the ongoing litigation between WWE and the Company, there was no certainty that the Company would be able to renew its license with WWE, thus any future distribution period was “highly speculative.” The court reasoned that if the Company were later able to extend the

license, a books and records demand might then be appropriate. Thus the court concluded “a demand in order to satisfy a purpose so disconnected from the likely course of events is not ‘reasonably related’ to [plaintiff’s] interest in the LLC.”

The second purpose offered by plaintiff was that it needed the documents to value its interest in the Company. According to the court, normally this would be a proper purpose for a demand, but here it was largely meaningless. The court reasoned that plaintiff only had an interest in the preferred return and had no residual equity interest. The value of plaintiff’s interest in the Company was simply the present value of the preferred return for the current distribution period. Thus, once the arbitrator determined the preferred return rate, the calculation of the value of plaintiff’s interest would be a matter of simple arithmetic, and there would be no need for further documents to determine what the value of that interest was. The court, therefore, concluded that the production of further documents could not reasonably serve the purpose of valuing plaintiff’s interest in the Company.

The last purpose offered by plaintiff was that it needed the documents to investigate mismanagement by THQ. The court stated that to support an allegation of mismanagement under a Section 18-305 action, a member is required to offer a credible basis to suspect mismanagement or wrongdoing, and, in this case, the court found that plaintiff failed to do so. The court was not convinced by the two witnesses offered by plaintiff that there was a credible basis to infer that THQ breached any of its duties under the LLC Agreement. Thus, the court denied plaintiff’s action to inspect the books and records of the Company under Section 18-305 of the LLC Act.

2. *In re NextMedia Investors, LLC*, C.A. No. 4067-VCS (Del. Ch. May 6, 2009)

The potential adoption of an amendment to an LLC agreement was the crux of this motion for summary judgment on the petition of certain members of NextMedia Investors, LLC (the “Company”) for (i) the judicial dissolution of the Company and (ii) the appointment of a liquidating trustee. The proposed amendment would have extended the date of dissolution of the Company by four years. Pursuant to the LLC agreement, the dissolution section, among others, could not be amended “to adversely affect any Member” without the consent of each member to be adversely affected. Petitioners argued that the proposed amendment, by extending the term of the Company, and therefore the members’ investment period, created an adverse effect and required the consent of all members for adoption. Since petitioners had not given their consent, they argued that the amendment was ineffective and the Company had dissolved. The Company countered that (i) petitioners’ interpretation of the amendment provisions of the LLC agreement was not reasonable or, in the alternative, another reasonable interpretation existed rendering the agreement ambiguous and (ii) whether petitioners were adversely affected was a relevant factual issue.

The court noted that summary judgment in the context of interpreting a contract requires that the contract be unambiguous. Assessing the amendment provision of the LLC agreement, the court found that the plain language of the agreement supported one reasonable meaning and therefore could not be considered ambiguous. The court agreed

with petitioners that the dissolution provision could not be amended without the consent of all members because all members would be adversely affected by the extension of the term of the Company, which would deny them the ability to withdraw from the Company on the investment horizon that was originally contemplated by the LLC agreement. The court rejected the Company's argument that the approval of the amendment by a majority of the members proved that the amendment did not have an objectively adverse effect. Such a reading, the court stated, would have converted the amendment provision into a class voting provision, but its plain language granted each individual member a consent right. After finding petitioners' interpretation to be reasonable, the court addressed the Company's alternative reading of the amendment provision, which would require consent only if the board of managers subjectively intended that a proposed amendment adversely affect the members. The Company's proposed reading was based on a technical reading of the words "to affect" to require intention or purpose. The court rejected this interpretation as inconsistent with the plain meaning of the section, stating that the Company's interpretation required "the type of awkward linguistic leap that this court will not make in giving a practical reading to a contract."

Significantly, the court also rejected the Company's final argument, namely, that petitioners were not entitled to summary judgment because they had not provided the court with the factual basis to conclude that they were adversely affected by the proposed amendment. The Company's position was that petitioners must prove to the court, as an issue of fact, that they were adversely affected by the proposed amendment in order to demonstrate that their consent was required. The Company bolstered its position by offering affidavits from its officers indicating that a liquidation of its assets upon the original dissolution date would have resulted in no distributions to the Company's equity holders because of the depressed market prices of those assets. The court, however, rejected the Company's argument. It held that whether petitioners were to be adversely affected for purposes of the amendment section was necessarily a "before the fact question" and stated that a company cannot determine "who is entitled to vote on an action by first carrying out the action and then seeing who is adversely affected." The court added that petitioners should not be required to show they were entitled to vote on the proposed amendment through factual evidence. Rather, the court held, the question of who was entitled to vote was best judged "by who can be reasonably expected to be adversely affected." The court continued that whether an amendment triggers an individual approval right "depends not on an empirical, factual assessment of whether a member is correct about the effect of a change in the contract, but on whether the proposed contractual amendment would alter an economically meaningful term. If it does, the individual approval right [of the amendment provision] is implicated" and the court found that a change to the lifespan of the entity like the one proposed was clearly a triggering amendment. Thus the court held that petitioners were entitled to dissolution.

While the court granted the dissolution of the Company, it declined to appoint a liquidating trustee. Under the terms of the LLC agreement, the board of managers was authorized to liquidate the Company and if the board of managers did not, the Class A members were entitled to appoint a liquidator. Under the LLC agreement, this right was specifically subject to the right of any member or creditor to apply to a court in respect of the dissolution of the Company and the court interpreted this language together with

Section 18-803 of the LLC Act to require petitioners at the very least to show cause as to why the Class A members should be denied their right to appoint the liquidating trustee. As petitioners had not done so, their motion to appoint a liquidating trustee was denied.

3. *In re Arrow Inv. Advisors, LLC*, C.A. No. 4091-VCS (Del. Ch. Apr. 23, 2009)

In this case, the petitioner sought the judicial dissolution of Arrow Investment Advisors, LLC (the “Company”), which was founded by the petitioner and two other individuals. The petitioner held a 30% stake in the Company and also had served as the Company’s CEO. The Company was formed for the purpose of acting as an investment advisor to certain investment funds and for such other lawful business as the management committee chose to pursue. In 2008, the Company encountered difficulties. A financial report sent to the members of the Company showed that the Company was operating at an almost \$275,000 loss for the first seven months of 2008. Consequently, the Company sought capital contributions from each of the members to support the Company’s entry into additional investment-related ventures.

Shortly after the request by the Company for additional capital contributions, petitioner sought judicial dissolution of the Company under Section 18-802 of the LLC Act. In response, the Company sought dismissal of petitioner’s action under Rule 12(b)(6). The court stated that for petitioner to be successful, petitioner must allege specific facts supporting a rational inference that the standard set forth in Section 18-802 for judicial dissolution has been met. Thus, petitioner must demonstrate that “it is not reasonably practicable to carry on the business in conformity with [the] limited liability company agreement.” The court further stated that the ultimate determination of whether to grant judicial dissolution was left to the discretion of the court. The court went on to state that due to the extreme nature of the remedy of judicial dissolution, the remedy was granted sparingly. Thus the court reasoned that the remedy would be granted only in situations “in which the LLC’s management has become so dysfunctional or its business purpose so thwarted that it is no longer practicable to operate the business, such as in the case of a voting deadlock or where the defined purpose of the entity has become impossible to fulfill.”

Petitioner argued that the Company should be dissolved because it failed to meet projections contained in its initial business plan and sought to pursue strategies that were not set forth in its initial business plan. In rejecting this argument, the court noted that this argument did not suggest the Company was unable to operate in accordance with its governing document, which is the test required by Section 18-802 of the LLC Act. Petitioner also argued that although the LLC Agreement contained a broad purpose clause that allowed the Company to enter into any business that the management committee chose to pursue, the Company’s purpose, nevertheless, should be read narrowly because a broad reading would render the court’s power under Section 18-802 of the LLC Act meaningless and render Section 18-802 of the LLC Act superfluous. The court rejected this argument as unpersuasive and reasoned that there could be a confluence of specific circumstances that “make it nihilistic for the [Company] to continue.” For example, dissolution might be appropriate where a petitioner is able to show that in spite of a manager’s intentions to pursue a business line allowed by the

LLC's governing instrument, it would be obviously futile and would not result in a business success. Further, the court reasoned that it could not conclude that a specifically negotiated provision of the LLC Agreement that allowed for a broad purpose should be used by petitioner prematurely to end the Company's existence because petitioner was unhappy with how the Company's management had chosen to exercise discretion granted to it in the LLC Agreement.

Petitioner also alleged breaches of fiduciary duty by the managers in support of his action to dissolve the Company. The court stated that the cursory nature of the allegations made in the complaint were inadequate and suffered from a number of deficiencies, including a failure to allege any specific facts to support allegations that the managers breached their fiduciary duties. Additionally, the court noted that termination of an LLC due to fiduciary breaches would be rare. Further, even if the allegations were sufficient, petitioner failed to pursue the action in the correct manner for at least two policy-based reasons. First, many breach of fiduciary duty claims belong to the entity itself, not its equityholders, and therefore the law has developed rules for bringing a derivative action. The LLC Act requires that a complaint set forth with particularity the effort of plaintiff to secure the initiation of the action by a manager or member or the reasons for not making the effort. Further, the demand rule exists, in part, to give an LLC the right to control litigation to address any alleged wrongs and Section 18-802 judicial dissolution actions should not be used to by-pass this right of the LLC. Second, petitioner's action to allege breaches of fiduciary duty also sought to by-pass certain procedural mechanisms set forth in the LLC Agreement, principally the requirement that "any questions, issues or disputes arising out of or relating to the" LLC Agreement be handled through negotiation then mandatory mediation and then, finally, binding arbitration prior to any lawsuit being brought. Because Delaware policy favors alternative dispute resolution mechanisms, the court held that petitioner could not use a Section 18-802 action as an end-run around the dispute resolution mechanisms contained in the LLC Agreement. Thus, the court granted the Company's motion to dismiss the petition with prejudice except that the court held dissolution could be sought at the end of the arbitration process if breaches of fiduciary duty were proven and a good faith argument could be made that the remedies granted by the arbitrator supported an order of dissolution.

4. *Bay Center Apartments Owner, LLC v. Emery Bay PKI, LLC*, C.A. No. 3658-VCS (Del. Ch. Apr. 20, 2009)

This action arose out of a failed development project between plaintiff Bay Center Apartments Owner, LLC ("Bay Center") and defendant Emery Bay PKI, LLC ("PKI"). PKI was owned and operated by defendant Alfred E. Nevis ("Nevis"). To effectuate the development project, Bay Center and PKI formed defendant Emery Bay Member, LLC, a Delaware LLC ("Emery Bay"), and designated PKI as its managing member. Emery Bay's LLC Agreement provided for PKI to manage the project, but the details of its management duties were defined in a separate Development Management Agreement, which was an exhibit to the LLC Agreement. Under the LLC Agreement, PKI was required to cause one of its subsidiaries to enter into the Development Management Agreement with the Development Manager, which was defined as PKI or one of its affiliates. PKI designated another Nevis-owned affiliate, defendant Emery Bay ETI, LLC

(“ETI”), as the Development Manager. Thus, the entity with primary responsibility for the success of the development project, the Development Manager, was not a contractual partner of Bay Center. Under the LLC Agreement, however, PKI had the power and authority to ensure that the Development Manager performed its obligations under the Development Management Agreement.

Soon after the project began, Emery Bay defaulted on a construction loan that Nevis had guaranteed. Bay Center alleged that defendants secretly renegotiated the loan on several occasions, which both diverted cash flow from the development project and allowed Nevis to avoid triggering his personal guarantee. After a series of other problems allegedly resulting from mismanagement by PKI’s affiliates, the development project failed and was put into receivership. In this case, Bay Center pursued a breach of contract claim against PKI, the only defendant that was party to the LLC Agreement, and sought to expand its remedial options by filing suit for breach of the contractually implied covenant of good faith and fair dealing, breach of fiduciary duty, common law fraud, and aiding and abetting a breach of fiduciary duty. This decision addressed defendants’ motion to dismiss all of Bay Center’s claims except for those based on breach of contract.

In its breach of contract claim, Bay Center argued that, under the terms of the LLC Agreement, PKI was required to cause ETI to perform its obligations under the Development Management Agreement and cause Emery Bay to perform its obligations under the loan documents. PKI, on the other hand, argued that it was simply empowered, not required, to cause these entities to perform such obligations. The court found the LLC Agreement to be ambiguous on this point and, for purposes of the motion to dismiss, construed the ambiguity against Bay Center. The court then examined the question of whether that obligation could be implied in the LLC Agreement. The court stated that Delaware courts have only sparingly applied the implied covenant of good faith and fair dealing, especially in detailed, complex agreements, but they have “recognized the occasional necessity of implying contractual terms to ensure the parties’ reasonable expectations are fulfilled.” In this case, the court found that PKI was required to act in good faith in managing Emery Bay and exercising its discretion to cause the supporting agreements to be performed. Thus, PKI could not “engage in ‘arbitrary or unreasonable conduct’ that had the effect of preventing Bay Center from ‘receiving the fruits of the bargain,’” which bargain in this case was that, in exchange for Bay Center’s contribution of real estate, Bay Center would enjoy the benefit of PKI’s project management skills and efforts. Because Bay Center pled facts from which it could be reasonably inferred that PKI’s actions were not in good faith, the court found that Bay Center had sufficiently pled that PKI had an implied duty of good faith to cause performance of the supporting agreements and that PKI had breached this duty.

With respect to Bay Center’s fiduciary duty breach claims, the court first looked to the provisions of the LLC Agreement regarding the fiduciary obligations of the members. One section of the LLC Agreement provided that members owed each other the default fiduciary duties that exist between members of an LLC except where the LLC Agreement provided otherwise but the very next section of the LLC Agreement provided that no member owed the other member any duty of any kind that was not imposed by the LLC Agreement itself. The court found these seemingly contradictory provisions to create an

ambiguity and, for purposes of the motion to dismiss, resolved the ambiguity in favor of an interpretation that the LLC Agreement required members to act in accordance with traditional fiduciary duties. The court thus denied defendants' motion to dismiss Bay Center's fiduciary duty claims against PKI.

Bay Center also alleged that Nevis, despite being neither a member nor an officer of Emery Bay, breached his fiduciary duty to Bay Center. The court stated that Nevis would be beyond the normal scope of those who owe fiduciary duties in the corporate context, but could be subject to fiduciary duties under the line of cases in the alternative entity context starting with *In re USACafes, L.P. Litig.*, 600 A.2d 43 (Del. Ch. 1991). The court held that to apply the *USA Cafes* doctrine to hold an affiliate liable for breach of fiduciary duty to an entity, the affiliate must exert control over the assets of that entity and, if such control is established, the affiliate only has "the duty not to use control over the partnership's property to advantage the corporate director at the expense of the partnership." The court, in attempting to resolve uncertainty regarding the scope of the duties under the *USACafes* doctrine, stated that limiting the application of *USACafes* to this duty provides a rational and disciplined way of protecting investors in alternative entities with managing members who are themselves entities, while not subjecting all the individuals who work for managing members to wide-ranging causes of action. The court found that Bay Center sufficiently pled that Nevis (a) exerted direct control over Emery Bay's property and (b) used such control to stave off personal liability. As such, the motion to dismiss this fiduciary duty claim against Nevis was denied.

The court next turned to Bay Center's aiding and abetting claims and stated that to allege a claim for aiding and abetting a breach of fiduciary duty, a plaintiff must plead: "(1) the existence of a fiduciary relationship; (2) the fiduciary breached its duty; (3) a defendant, who is not a fiduciary, knowingly participated in a breach; and (4) damages to the plaintiff resulted from the concerted action of the fiduciary and the nonfiduciary." The court found that Bay Center had pled sufficient facts in this regard and thus denied defendants' motion to dismiss the aiding and abetting claims.

With respect to Bay Center's common law fraud allegations, the court stated that there are three ways to demonstrate common law fraud: (1) overt misrepresentation; (2) silence in the face of a duty to speak; or (3) deliberate concealment of material facts. In its claim, Bay Center argued that PKI and Nevis had a duty to speak and failed to do so. The court stated that to commit common law fraud through silence, a defendant must have a duty to speak that arises by operation of law, not purely by contract. For purposes of this motion, the court considered PKI subject to traditional fiduciary duties and held that fiduciaries of an LLC have a duty to disclose fully and fairly all material information within their control when they seek members' consent. Because the LLC Agreement required Bay Center's consent for any refinancing or restructuring of loans and the facts alleged showed that PKI failed to notify Bay Center of six of seven loan modifications, the court held that Bay Center successfully pled its fraud claim against PKI. The court stated that under Delaware law, "[a] corporate officer can be held personally liable for the torts he commits and cannot shield himself behind a corporation when he is a participant," which includes situations where a corporate agent participates in corporate

fraud. On this basis, the court found that Bay Center had a proper claim against Nevis for his individual participation in PKI's fraud.

5. *Kuroda v. SPJS Holdings, L.L.C.*, C.A. No. 4030-CC (Del. Ch. Apr. 15, 2009)

Plaintiff was a member of defendant SPJS Holdings, L.L.C., a Delaware limited liability company ("SPJS"). Because of disagreements with his fellow members, plaintiff decided to withdraw from SPJS. Plaintiff and defendants entered into negotiations regarding his withdrawal, but the parties were unable to reach an agreement on the amount plaintiff was owed under the parties' agreements or resolve a controversy surrounding an allegedly inaccurate Schedule K-1. Plaintiff also alleged that the defendants attempted to undermine his reputation and undermine his economic opportunities in order to save their personal reputations, and plaintiff brought an action against SPJS and his fellow members for: (a) breach of contract, (b) tortious interference with contract, (c) tortious interference with prospective economic advantage, (d) breach of the implied covenant of good faith and fair dealing, (e) conversion, (f) unjust enrichment, and (g) civil conspiracy.

In their motion to dismiss, defendants Liberty Square Asset Management, L.L.C. ("Liberty Square") and WGL Capital Corp. ("Capital"), the managing members of SPJS, argued that the breach of contract claims against them should be dismissed because they were not liable for SPJS's purported breaches of the LLC agreement and pointed to language in the LLC agreement that tracked Section 18-303(a) of the LLC Act. While the court acknowledged that the provision of the LLC agreement did limit the liability of members of SPJS, the court held that it did not necessarily limit the liability of the managing members for the kinds of breaches alleged in plaintiff's complaint. Accordingly, their motion to dismiss was denied.

Plaintiff also alleged that SPJS, Liberty Square and Capital breached provisions of the LLC agreement when they issued a Schedule K-1 that improperly assigned him taxable income. To state a claim for breach of contract, the court stated that a plaintiff "must demonstrate: first, the existence of a contract, whether express or implied; second, the breach of an obligation imposed by that contract; and third, the resultant damage to the plaintiff." The court dismissed plaintiff's claim because (a) plaintiff, a Japanese citizen, failed to establish that he paid or even owed taxes in the U.S. or that he paid higher taxes or suffered any adverse consequence as a result of the schedule, and (b) plaintiff failed to make the contention that a tax audit was a logical and reasonably foreseeable consequence in his complaint, and, even if he had, such a speculative harm was not sufficient to state a claim for breach of contract.

Next, plaintiff argued that the principals of SPJS, Capital and Liberty Square tortiously interfered with plaintiff's contractual interests under the LLC agreement because they caused SPJS, Capital and Liberty Square to breach the contract. Because a party to a contract cannot be held liable for both breaching the contract and for tortiously interfering with that contract, plaintiff must show that these defendants were each "a stranger to both the contract and the business relationship giving rise to and underpinning the contract." As such, insofar as these defendants acted within the scope of their respective roles in the entities, they could not be held liable for tortious interference with

contract. No factual allegation in the complaint sufficiently demonstrated that any defendant exceeded the scope of his authority. Accordingly, the claim was dismissed.

With regard to plaintiff's claim for tortious interference with prospective economic advantage, the court stated that such a claim will survive a motion to dismiss where a plaintiff alleges: "(a) the reasonable probability of a business opportunity, (b) the intentional interference by defendant with that opportunity, (c) proximate causation, and (d) damages." Further, under Delaware law, direct claims relating to an LLC are only available where the member of the LLC has suffered damage that is independent of any damage suffered by the LLC. Because all of the harm allegedly suffered by plaintiff affected him through his interest in the LLC through which he did business, the court held that any claim for damages must be asserted by that LLC. Plaintiff failed properly to assert a derivative claim on behalf of that LLC. As such, the claim was dismissed.

In support of his claim for breach of the implied covenant of good faith and fair dealing, plaintiff alleged "arbitrary, unreasonable, and/or deceitful conduct" on the part of defendants. In its analysis, the court held that the implied covenant of good faith and fair dealing "requires a party in a contractual relationship to refrain from arbitrary or unreasonable conduct which has the effect of preventing the other party to the contract from receiving the fruits' of the bargain." However, it cannot be used to override the express terms of the contract. The court stated that to state a claim for breach of the implied covenant, a plaintiff must allege (a) a specific implied contractual obligation and (b) how the violation of that obligation denied the plaintiff the fruits of the contract. Because of its narrow purpose, the court added the implied covenant of good faith and fair dealing is only rarely invoked successfully. The court held that plaintiff failed to state a proper claim because his claim regarding defendants' failure to pay money due under the contract was governed by the express terms of the contract. Further, to the extent that plaintiff's claim was based upon allegations concerning defendants' attempts to undermine his reputation, plaintiff failed to allege any contractual benefit that he was denied as a result of such conduct. Accordingly, the claim was dismissed.

Conversion, the court stated, is any distinct act of dominion wrongfully exerted over the property of another in denial of the plaintiff's right or inconsistent with it. A plaintiff who wishes to assert a tort claim in addition to a contract claim must allege that the defendant violated a legal duty separate from its contractual duties. The court dismissed plaintiff's complaint because he failed to identify an interference with his right to the money that arose independently of the rights granted to him under the contract. Additionally, plaintiff's claim failed to fall within a narrow exception to the general rule prohibiting claims for the conversion of money—recognized in other jurisdictions, but not in Delaware—that permits a claim "only when it can be described or identified as a specific chattel, but not where an indebtedness may be discharged by the payment of money generally."

As to plaintiff's claims of unjust enrichment, the court defined such a claim as "the unjust retention of a benefit to the loss of another, or the retention of money or property of another against the fundamental principles of justice or equity and good conscience." The court continued that the claim was not available where there was a contract that

governed the relationship between the parties. Because plaintiff's complaint alleged that defendants were unjustly enriched by services that he provided pursuant to their consulting agreement, it was clear that the parties' relationship was governed by an express contract. While the plaintiff argued that his claims against certain defendants should not be dismissed because they were not parties to the relevant contracts, the court held that unjust enrichment could not be used "to circumvent basic contract principles recognizing that a person not a party to a contract cannot be held liable to it."

Finally, plaintiff brought a claim against defendants for civil conspiracy, alleging that they "knowingly entered into a confederation or combination to pursue unlawful ends vis-à-vis [plaintiff], including violations of implied covenants of good faith and fair dealing and tortious interference with [plaintiff's] contractual interests and economic expectancies." The court held, however, that civil conspiracy was not an independent claim. To be actionable, a civil action must embody an underlying wrong that would be actionable in the absence of the conspiracy. Because plaintiff failed to allege such a wrong, the court dismissed the claim.

6. *Estate of Burke v. Eric S. Burke Home Improvement*, C.A. No. 3322-CC (Del. Ch. Apr. 14, 2009)

This case involved a Delaware LLC formed by two brothers, each of whom owned a 50% membership interest. Following the death of one of the brothers, his wife became vested in his 50% share of the LLC. The wife had a very contentious relationship with the other brother and filed a petition seeking judicial dissolution of the LLC, claiming that she and the other brother were hopelessly deadlocked. This decision addressed the parties' cross-motions for summary judgment.

The court denied the motions, stating that in this case the determination of "whether it is 'reasonably practicable' to carry on the business and operations of the LLC" is a mixed question of law and fact that must be determined by a trial. The court stated, however, that based on the precedent set in *Haley v. Talcott*, 864 A.2d 86 (Del. Ch. 2004), in which the court ordered the dissolution of a two 50% member LLC where the members were deadlocked over business strategy, it was "exceedingly likely" that the court would order the dissolution of the LLC. The court urged the parties to reach an amicable compromise to unwind their relationship to avoid a difficult and expensive trial and cautioned that the result of such a trial likely will be a court-ordered sale of the business, the costs of which may well result in nothing being left to divide among the members.

7. *Mickman v. American Int'l. Processing, L.L.C.*, C.A. No. 3869-VCP (Del. Ch. Apr. 1, 2009)

In this case involving cross-motions for summary judgment, the court addressed the issue of what evidence would be admissible to prove standing for purposes of a books and records demand under Section 18-305 of the LLC Act. Defendant LFF, L.L.C. ("LFF") argued that plaintiff was not entitled to inspect LFF's records because, according to LFF's documents, she was neither a member nor a manager of LFF. While plaintiff conceded that she was not listed as a member in either the operating agreement or its

amendments, she argued that contemporaneous documents signed by the initial two members of LFF, Richard Mickman (her ex-husband) and Howard Gleit, supported a reasonable inference that she was a member. One document, a 2001 tax return for LFF, which included a Schedule K-1 for each member, listed the members as Howard Gleit and Richard and Elaine Mickman. In a second document, signed prior to the couple's divorce, Richard Mickman signed under penalty of perjury an Offer in Compromise to the IRS in which he stated that his "only assets [were] his house . . . and stock in a number of closely held companies owned jointly by Taxpayer and his wife."

Section 18-305 of the LLC Act states that "[e]ach member of a limited liability company has the right . . . to obtain from the limited liability company from time to time upon reasonable demand for any purpose reasonably related to the member's interest as a member of the [LLC] . . . [various records of the LLC]." Relying on *Shaw v. Agri-Mark, Inc.*, 663 A.2d 464 (Del. 1995), LFF argued that the court should apply the same evidentiary standard for an LLC as it does for a corporation in considering a demand for books and records. For purposes of a request for books and records under Section 220 of the Delaware General Corporation Law, only those stockholders listed in the stock ledger are recognized as holders of record of stock. A party that supplies equity to a stock corporation, but is not a stockholder of record, has no right to inspect the corporation's books and records. As such, LFF argued that only those members listed in its operating agreement should be recognized as having a right to inspect its books and records. The court disagreed, however, stating that, due to the flexible and less formal nature of LLCs, it is reasonable for the court "to consider any evidence beyond the four corners of the operating agreement, where, as here, the plaintiff has presented admissible evidence that, notwithstanding the language of the operating agreement, suggests the parties to that agreement intended to make, and believed they had made, the plaintiff a member of the LLC."

Despite LFF's contentions that the representations in the aforementioned documents were simply mistakes, the court held that LFF's argument raised factual issues that could not be determined on a motion for summary judgment. Therefore, LFF's motion for summary judgment was denied.

8. *In re ECH Mgmt., LLC*, C.A. No. 3126-CC (Del. Ch. Mar. 12, 2009); *In re ECH, LLC*, C.A. No. 3127-CC (Del. Ch. Mar. 12, 2009)

Two Delaware limited liabilities companies (the "LLCs") were formed by four siblings to hold and manage certain real property. To take significant action with respect to the respective real property, each LLC operating agreement required the unanimous consent of the members, who were the four siblings. The members could not agree on whether to keep the properties or sell them. Because of this deadlock, three of the members sought judicial dissolution under Section 18-802 of the LLC Act. The other member-sibling opposed judicial dissolution and filed a counterclaim (among others) in which she alleged that her right to vote under the operating agreements had been interfered with or coerced by her siblings' refusal to accede to her position regarding the sale of the properties. She specifically requested that the court enjoin her siblings from proceeding with the litigation in order to vindicate her "right to vote" under the operating agreements. The

court was presented with a motion to dismiss this claim brought by the other members. The court did not reach the merits of this issue as it determined the issue was premature, but the court noted that it seemed “highly dubious” that the court would conclude that the member’s right to vote had somehow been infringed upon or coerced in the context of the family feud. In this regard, the court observed that the member asserting this counterclaim attested in her own pleadings to her full exercise of her voting authority by withholding her consent to the sale of the properties or the dissolution of the LLCs.

9. *BASF Corp. v. POSM II Props. P’ship., L.P.*, C.A. No. 3608-VCS (Del. Ch. Mar. 3, 2009)

Plaintiff BASF Corporation (“BASF”), a limited partner of a Delaware limited partnership, brought this action against the partnership and the general partner for a declaration that its right to withdraw from the partnership and to have its partnership interest bought out by the general partner had been triggered. The purpose of the partnership as articulated in its partnership agreement was to own a petrochemical facility (the “Plant”). When the partnership was formed, in addition to the partnership agreement, the general partner entered into a supplementary agreement with each limited partner setting forth such limited partner’s capital contribution obligations and other matters. BASF’s supplementary agreement provided that if the general partner were to become aware “that the Plant no longer is to be operated by [Lyondell Chemical Company (“Lyondell”)] or its Affiliates (as defined in the Partnership Agreement), it shall so notify [BASF], such notification to be given at any time up to thirty days after the date of such change in operation. Upon receipt of such notice, [BASF], shall have ninety days to notify [POSM II Properties] that it wishes to withdraw from the partnership.” The supplementary agreement then provided a mechanism for purchase of BASF’s partnership interest upon such a withdrawal. Following a “going private” transaction in which all of Lyondell’s stock was acquired by a privately held chemical group, BASF attempted to invoke this right to withdraw. BASF argued that the change in control of Lyondell was a change in the operator of the Plant or, alternatively, that Lyondell’s new corporate parent, rather than Lyondell, was actually operating the Plant. This opinion addressed defendants’ motion to dismiss.

In considering the first of BASF’s arguments, the court found that the plain language of the supplementary agreement contemplated a situation in which Lyondell or one of its affiliates was no longer operating the Plant rather than a change in control of Lyondell. BASF argued that the change in control of Lyondell resulted in Lyondell having a sole stockholder that controlled Lyondell and was in a position to influence Lyondell and therefore indirectly operate the Plant. The court stated that this did not, in and of itself, mean that Lyondell was no longer operating the Plant, nor did the change in the ownership of Lyondell’s equity render it a different company. The court stated that if the supplementary agreement were construed as BASF suggested, it would mean that there was a change in the operator of the Plant and that a withdrawal right existed whenever Lyondell’s stockholder base changed in some significant way or its stockholders or any third party influenced the operation of the Plant. The court further stated that had the parties intended to give BASF withdrawal rights upon a change in control of Lyondell, they could have included an express provision in the supplementary agreement granting

BASF this right upon an acquisition of Lyondell by another company, changes to the board or management of Lyondell or modification of the capital structure of Lyondell. The court stated that BASF's withdrawal right under the supplementary agreement is only triggered if Lyondell no longer operates the Plant, which Lyondell may continue to do even if it experiences a change in control of its equity. The court thus refused to adopt BASF's argument for an expansive interpretation of the withdrawal provision in the supplementary agreement. The court also rejected BASF's alternative argument that Lyondell's corporate parent was in fact operating the Plant. The court noted that BASF did not plead any facts suggesting that Lyondell's officers and employees were no longer directly managing and operating the Plant or that operations of the Plant were changed in any way after the acquisition of Lyondell by a single owner.

10. *Spellman v. Katz*, C.A. No. 1838-VCN (Del. Ch. Feb. 6, 2009)

Plaintiff and defendant each owned a 50% interest in a Delaware LLC formed for the purpose of constructing an office building in which the parties leased space for their joint medical practice. After a falling out between the two parties, plaintiff left to practice on his own and plaintiff and defendant were unable to agree on how to unwind their relationships. Plaintiff ultimately sought a decree of judicial dissolution of the LLC pursuant to Section 18-802 of the LLC Act or, alternatively, an order pursuant to Section 18-803 of the LLC Act appointing a liquidating trustee to effectuate the winding up of the LLC because the LLC had allegedly already dissolved by express will of its members pursuant to Section 5.1 of the LLC agreement. Section 5.1 of the LLC agreement provided, in relevant part, that the LLC "shall be dissolved and its affairs wound up as soon as possible after the construction of the building had been completed, the condominium documents have been finalized and a certificate of occupancy has been issued with respect to each condominium unit"

Both parties conceded that each of the preconditions to dissolution set forth in Section 5.1 of the LLC agreement had been satisfied. Defendant argued, however, that the dissolution and winding up of the LLC was improper because Section 5.1 of the LLC agreement did not accurately reflect the original intentions of the parties regarding dissolution. Defendant asserted that neither party knew that Section 5.1 was part of the LLC agreement and, thus, that it did not embody their true intentions and should not be enforced. In support of this position, defendant argued that the failure of either party to take steps to implement the dissolution and winding up of the LLC as called for in the LLC agreement was evidence of the parties' "true intent" to continue the LLC indefinitely.

Applying general contract principles to the construction of the LLC Agreement, the court concluded that Section 5.1 of the LLC Agreement was unambiguous and should be enforced in accordance with its terms. The court held that because Section 5.1 of the LLC agreement was found to be unambiguous on its face, the parol evidence rule precluded the introduction of outside evidence to dispute its terms. Consequently, the court held that the LLC had been dissolved by express will of its members pursuant to Section 5.1 of the LLC agreement and that the winding up of its affairs was necessary.

With respect to plaintiff's request for the appointment of a liquidating trustee pursuant to Section 18-803 of the LLC Act, the court held that because the parties were deadlocked on how to proceed with the winding up of the LLC, the only rational and equitable result was for the court to appoint such a person. The court stated that because the LLC had been dissolved by the express will of its members and the parties were unable or unwilling to implement the winding up process that naturally follows dissolution in the life cycle of an LLC, "cause" within the meaning of Section 18-803(a) of the LLC Act existed for the court to appoint a liquidating trustee to wind up the LLC's affairs. Thus, plaintiff's motion for summary judgment on its petition for appointment of a liquidating trustee was granted.

In connection with plaintiff's petition for appointment of a liquidating trustee, defendant asserted a counterclaim, derivatively on behalf of the LLC, alleging that plaintiff had breached his fiduciary duties to the LLC by refusing to participate in the refinancing of the building's mortgage. Plaintiff moved to dismiss defendant's counterclaim for failure properly to plead demand futility with the particularity required by Court of Chancery Rule 23.1. Defendant argued that demand futility has been sufficiently demonstrated because plaintiff, by virtue of his 50% interest in the LLC, may effectively veto any proposed action and it would be futile to request that plaintiff grant permission to the LLC to sue himself for the alleged conduct. The court held that to show demand futility, defendant must (i) show a "substantial likelihood" of plaintiff's personal liability and (ii) plead "with particularity" the facts supporting his claim that there is a "substantial likelihood" of personal liability of plaintiff. The court held that the "mere threat" of personal liability is insufficient to show a substantial likelihood of personal liability. In this case, the court held that defendant had pleaded only the naked assertion of a breach of fiduciary duty by plaintiff and, thus, the counterclaim showed no more than a mere threat of personal liability, which was insufficient to satisfy the defendant's pleading requirements. Plaintiff's motion to dismiss the counterclaim was therefore granted.

11. *Fisk Ventures, LLC v. Segal*, C.A. No. 3017-CC (Del. Ch. Jan. 13, 2009)

Petitioner, Fisk Ventures, LLC, sought judicial dissolution of Ginitrix, LLC (the "Company") pursuant to Section 18-802 of the LLC Act. Petitioner was a Class B member of the Company and the respondent, Andrew Segal ("Segal"), was the sole holder of Class A membership interests in the Company. Under the Company's LLC Agreement, the Company's board could only act pursuant to approval of 75% of the members of the board. Thus, the Company could not act without the agreement of the Class A representatives and the Class B representatives. The Company had been involved in a long-lived corporate dispute that resulted in a deadlocked board. The issue before the court was whether it was "reasonably practicable" under Section 18-802 of the LLC Act for the Company to continue to operate its business in conformity with its LLC Agreement. Petitioner made a motion for judgment on the pleadings which the court granted.

In reviewing petitioner's motion, the court stated that the test for judicial dissolution is whether it is reasonably practicable for the Company to carry on its business, not whether it is impossible. The court stated that several factual circumstances have frequently been

cited in the case law: (1) whether the members' vote is deadlocked at the board level; (2) whether the operating agreement gives no means of navigating around the deadlock; and (3) whether due to the financial condition of the company, there is effectively no business to operate. The court noted that the foregoing circumstances were not individual dispositive, nor did they all have to exist for the standard to be met. In the present case, however, the court found more than sufficient undisputed evidence that all three factors were present and, therefore, it was not reasonably practicable to carry on the business of the Company in conformity with its LLC agreement. Segal had argued that the LLC Agreement granted petitioner a "put right" which would permit petitioner to exit the Company at fair market value for any reason or for no reason, and this put right was a provision that could resolve the board's deadlock. The court, however, rejected this argument, reasoning that the put right was a right of petitioner's and not a right of the Company. Thus, it would be inequitable for the court to force petitioner to use its put right to exit its investment if it did not deem it to be in its best interest. The court went on to state that it would not second guess a party's business decision in choosing whether to exercise its previously negotiated option rights.

Segal also argued that a dissolution would destroy any value the Company had preserved in valuable patent rights. The court rejected this argument reasoning that a potential purchaser could structure the transaction to reap the benefits of the Company's patent rights. Further the court found that the parties would never be able to reach agreement on how to dispose of the patent rights regardless of their potential value. Finally, Segal argued that petitioner could not seek judicial dissolution because it came to the court with unclean hands. Segal argued that petitioner had unclean hands because it had used its contractually negotiated rights under the LLC Agreement to benefit itself, but the court held that petitioner had the right to maximize its position in accordance with the terms of the LLC Agreement. Finally, the court rejected Segal's argument that petitioner sought dissolution simply to buy the Company's assets at fire sale prices, finding that he presented no support for such contention. The court concluded that because the Company's financial progress was impeded by a deadlock in the boardroom and the deadlock could not be remedied through a legal mechanism set forth within the four corners of the operating agreement, dissolution was the only remedy available as a matter of law. The court stated that it would not re-draft the LLC Agreement for the sophisticated and well-represented parties. Thus, the court granted petitioner's motion seeking judgment on the pleadings on its petition for dissolution of the Company.

12. *Kahn v. Portnoy*, C.A. No. 3515-CC (Del. Ch. Dec. 11, 2008)

Plaintiff initiated the present litigation by filing a derivative complaint alleging that defendants, who were directors of Travel Centers of America, LLC (the "Company"), breached their fiduciary duties to the Company. The individual directors filed a motion to dismiss plaintiff's action under Rules 12(b)(6) and 23.1. This opinion addresses defendants' motion. In 2007, the Company along with Hospitality Trust ("HPT"), a company controlled by defendant director Barry Portnoy ("Portnoy"), acquired Petro Stopping Holdings, L.P. and Petro Stopping Centers, L.P. In connection with this transaction, HPT leased the real estate it acquired in the transaction to the Company (the "Petro Lease Agreement"). Plaintiff alleged that the terms of the Petro Lease Agreement

were more favorable to HPT than to the Company and required the Company to pay HPT above-market rent. Plaintiff also alleged that the directors breached their fiduciary duties by approving the transaction to benefit, at the expense of the Company, HPT, Portnoy and Reit Management & Research (“RMR”), a company controlled by Portnoy, which provided management and administrative services to the Company. According to plaintiff, pursuant to the RMR management agreement, the Petro Lease Agreement benefited HPT because it was able to collect above-market rents and it benefited RMR (and therefore Portnoy) because RMR collects a fee percentage of the gross rent collected by HPT.

The court began its analysis by looking at the terms of the LLC Agreement to determine what fiduciary duties the directors owed the Company and whether the directors could be personally liable if they breached those duties. The LLC Agreement provided that the authority, powers, functions and duties (including fiduciary duties) of the board would be identical to those of a board of directors of a Delaware corporation under the DGCL, unless otherwise specifically provided for in the LLC agreement. Defendants argued that Section 7.5(a) of the LLC Agreement modified the board of directors’ duties and altered the pleading standard required under Rule 12(b)(6) by creating a presumption that the board of directors acted in accordance with its duties, notwithstanding that the board’s decision might have been interested. Further, plaintiff could only overcome that presumption by clear and convincing evidence. The court, however, found that defendants’ interpretation of Section 7.5(a) was not the only reasonable interpretation of that provision. Specifically, defendants interpreted Section 7.5(a) as applying to a conflict between directors and the Company, but the court found that Section 7.5(a) could also reasonably be interpreted as applying only to conflicts between (i) a shareholder and the board or (ii) a shareholder and the Company. Here, the conflict was between Portnoy who was a director, and the Company; thus under one of the two reasonable interpretations of Section 7.5(a), that section would not apply to the conflict at issue. On a Rule 12(b)(6) motion, the court held that it was required to adopt the reasonable interpretation that favored the nonmoving party. Furthermore, the court noted that even assuming that Section 7.5(a) applied, it would not necessarily alter the pleading standard as the court would not apply a standard of proof at the motion to dismiss stage and, therefore, plaintiff would not need to meet the heightened evidentiary standard set forth in the applicable provision at the pleading stage.

Next, the court discussed what fiduciary duties the directors owed to the Company. The LLC Agreement provided that the directors had the same powers and duties (including fiduciary duties) as a board of directors of a Delaware corporation, meaning they would owe the dual duties of due care and loyalty. Although the LLC Agreement modified the directors’ duties for certain transactions, under one of the two reasonable interpretations of Section 7.5(a), that modification would not apply to conflicts between directors and the Company. Therefore, for purposes of the motion to dismiss, the court assumed that the directors’ duties were defined by the duties owed by directors of a Delaware corporation.

Next the court discussed whether the director defendants could be personally liable for violating their duties. The LLC Agreement contained two different, and arguably

conflicting exculpation provisions. Although both provisions provided the directors with exculpation for their acts under various circumstances, neither provision provided exculpation for personal liability where the director acted in bad faith. Given the allegations, the court concluded that based on the limited record and the requisite assumptions made in plaintiff's favor at this stage, plaintiff made a sufficient showing to rebut the presumption that the directors acted in good faith. The court stated that Portnoy's loyalties were divided with respect to the Petro Lease Agreement because in approving the transaction he was acting as a director for both HPT and the Company, which at least raised a reasonable doubt as to whether he was acting in the best interest of the Company. Further Portnoy would benefit personally due to his interest in RMR if the Company were bound to pay above market rents. With respect to the other directors, the court concluded that the complaint contained sufficient allegations to support the claim that each director was beholden to Portnoy and approved the Petro Lease Agreement to benefit Portnoy. Thus because the court concluded that it was possible for plaintiff to show that the directors acted in bad faith, plaintiff had met the notice pleading burden of Rule 12(b)(6).

To maintain a derivative suit on behalf of an LLC, a member must either (i) make demand on the managers to bring the suit or (ii) show that "an effort to cause the managers or members to bring the action is not likely to succeed." Thus, because plaintiff did not claim that demand was made on the board, the analysis turns on whether plaintiff properly alleged demand futility. Under the familiar *Aronson* test, applicable to derivative suits, the allegations in the complaint must allege particularized facts that establish a reasonable doubt that "(1) the directors are disinterested and independent [or] (2) the challenged transaction was otherwise the product of a valid exercise of business judgment." Defendants argued that the first prong of the *Aronson* test was unavailable to plaintiff because Section 7.5(a) modified the requirement for demand futility by creating a presumption that the decision of whether to pursue a lawsuit was disinterested, notwithstanding that the board may be interested. First, the court reiterated that the LLC Agreement could be interpreted as not applying in a conflict between a director and the Company and therefore Section 7.5(a) did not alter the application of the *Aronson* test. Further, even assuming Section 7.5(a) applied, because plaintiff was not required to meet any standard of proof, the court was not convinced Section 7.5(a) would change the *Aronson* test. Therefore, the court went on to apply the *Aronson* test to determine if a demand on the board would have been futile and under the first prong stated that the plaintiff must create a reasonable doubt as to the disinterestedness or independence of at least three of the five directors of the Company. The court concluded that plaintiff's complaint created a reasonable doubt as to the disinterestedness or independence of a majority of the Company's board.

With respect to Portnoy and defendant Thomas M. O'Brien ("O'Brien"), the court concluded that they were both interested under the first prong of *Aronson*. Portnoy was interested in the Petro Lease Agreement because he was a director for both the Company and HPT and owed fiduciary duties to both companies. Additionally, Portnoy was owner of RMR, which would receive fees from HPT which were allegedly increased by above-market rent payments from the Company. O'Brien was a director of the Company, a senior officer of RMR and held positions with a number of other Portnoy-related entities.

The court concluded that because of the payments RMR would receive from HPT and his position as Senior Vice President of RMR, there was a reasonable doubt as to whether O'Brien stood on both sides of the transaction. Further, the court noted that due to the "extensive relationships" between O'Brien and several Portnoy-related entities, there was also a reasonable doubt as to whether he was so beholden to Portnoy that he would be unable to exercise independent business judgment regarding the derivative action.

With respect to the other defendant directors Arthur G. Koumantzelis ("Koumantzelis"), Barbara D. Gilmore ("Gilmore") and Patrick F. Donelan ("Donelan"), the court concluded that plaintiff's complaint was sufficient to create a reasonable doubt as to their independence. The court noted that ordinarily, reasonable director compensation, without more, is not enough to establish that a director was not independent. However, in this case the facts alleged in the complaint suggested that Koumantzelis, Gilmore and Donelan had relationships with numerous other Portnoy-related entities and received compensation for serving as directors or officers for such entities. Thus, due to the relationships of Koumantzelis, Gilmore and Donelan with Portnoy-related entities and the compensation received by them for their service to Portnoy-related entities, the court concluded that the complaint created a reasonable doubt as to their independence. Further, the court stated "there is not a single director on the [Company] board who could serve as an independent voice, free of the potential influence of serving in a paid position of another Portnoy-related entity." The court also noted that when the relationships of each of the Company directors to other Portnoy-related entities are considered together with the allegations of a conflicted transaction with Portnoy-related entities, it was clear that there was a reasonable doubt that the Company board would be able to exercise disinterested and independent business judgment in deciding whether to pursue the derivative action. Thus the court found that demand was futile and ultimately denied defendants' motion to dismiss.

13. *Travelcenters of America LLC v. Brog*, C.A. No. 3751-CC (Del. Ch. Dec. 5, 2008)

Plaintiff, Travelcenters of America LLC (the "Company"), sought indemnification from defendants, who were shareholders of the Company, for costs incurred by the Company related to a proposal by defendants to nominate two persons to the board of directors of the Company which the court had previously held, in a declaratory judgment action brought by the Company, failed to comply with the detailed notice procedures required by the Company's LLC Agreement for a shareholder to nominate a member to the board of directors. The Company argued that it was entitled to indemnification pursuant to Section 10.3 of the Company's LLC Agreement, which provided that "each shareholder . . . will indemnify [the Company] from and against all costs and expenses, including reasonable attorneys' and other professional fees, arising from such shareholder's breach of any provision of the LLC Agreement." Defendants moved for judgment on the pleadings. This opinion addresses defendants' motion for judgment on the pleadings.

The court held that for the Company to recover under Section 10.3 of the Company's LLC Agreement, the Company would need to show that defendants breached the Company's LLC Agreement. The Company argued that defendants breached the

Company's LLC Agreement by failing to comply with Section 9.7 of the Company's LLC Agreement, but the court rejected this argument. The court reasoned that there is a distinction between promises and conditions, and that while the non-performance of a promise can result in a breach of a contract, the non-occurrence of a condition is not considered a breach unless the party promised that the condition would occur. Accordingly, unless a party is under a duty that a condition occur, the non-performance of a condition is not a breach of that agreement. In this case the court concluded that the requirements of the notice provision were conditions to the Company's performance and not promises by the shareholders. Although the Company acknowledged that the notice provision was a condition, it argued that it was also a promise by shareholders not to submit non-compliant notices. In support of this contention, the Company relied on the "mandatory" language in the notice provision of the Company's LLC Agreement. In rejecting this argument, the court explained that the presence of mandatory words such as "must" and "shall" did not compel a finding that the notice requirements were promises not to submit non-compliant notices. The notice requirements were conditions to the nomination of a person for election as a director. Therefore, defendants' failure to comply with the notice provisions was not a breach of the Company's LLC Agreement entitling the Company to indemnification but rather was merely the non-occurrence of a condition. Thus, the court concluded that defendants were entitled to judgment as a matter of law and granted their motion for judgment on the pleadings.

14. *In re Cencom Cable Income Partners, L.P. Litig.*, C.A. No. 14634 (Del. Ch. Nov. 26, 2008)

In its fourth opinion in the *Cencom* case, the court considered the general partner's motion for summary judgment on the three claims that remained after the prior proceedings and the limited partner's cross-motion for partial summary judgment on the claim with respect to the termination of distributions. As to the claim with respect to the scope and potential breach of the general partner's voluntarily-assumed duty in confirming the fairness of the sale, the general partner argued that the limited partner's rights to enforce such a duty were based in promissory estoppel, making lack of reliance by the limited partner fatal to its claim. The court rejected the general partner's promissory estoppel argument, with its basis in contractual principles, given that the duty voluntarily assumed by the general partner was a common law fiduciary duty and therefore denied the motion for summary judgment. The general partner also advanced a new argument with respect to the claim arising from its termination of distributions prior to the closing of the sale, namely, that the cash held by the partnership between the effective date of the sale and the closing date of the sale was for the benefit of the purchasers and not available for distribution. Because title to the partnership's assets was not transferred until the closing date, the court rejected this argument and denied summary judgment to the general partner. The court noted, however, that in a trial it could be determined that the interest paid on the purchase price between the effective date and the closing date compensated the limited partner for the loss of the distribution, rendering it unable to prove damages. (The court also rejected the limited partner's cross-motion for summary judgment on this claim, deeming it the equivalent of a motion to reconsider.) On the third claim relating to the appraisal of the partnership's assets, the court as it had in the two prior proceedings found the record inadequate to support

summary judgment on the question of the valuation of the assets individually or in the aggregate. In addition, the court denied summary judgment on the general partner's newly advanced argument that because the purchase price exceeded the value of the assets regardless of the method of calculation, the limited partner was without damages, stating it to be a question of fact not law. Finally, the disclosure issue with respect to the appraisal claim was split into the sub-issues of whether the general partner's presentation of the appraisals conformed to standard techniques and whether such presentation adequately disclosed all material facts, with the court granting summary judgment to the general partner on the first, but not the second.

15. *Brinckerhoff v. Tex. E. Prods. Pipeline Co., LLC*, C.A. No. 2427-VCL (Del. Ch. Nov. 25, 2008)

Plaintiff, a limited partner of a Delaware master limited partnership, brought this proceeding as a class action on behalf of unitholders and derivatively on behalf of the partnership against the general partner and other related entities of the partnership and certain directors of the partnership and the general partner alleging breach of the directors' fiduciary duties and failure to disclose material information in connection with the solicitation of limited partners' votes on the general partner's proposals to exchange certain of its distribution rights for limited partnership units and to amend the partnership agreement. Defendants moved to dismiss the fiduciary duty claims against some of the directors for failure to sufficiently plead facts as to their involvement in allegedly unfair transactions and to dismiss all of the disclosure claims.

While the immediate issue involved the general partner's acquisition of additional limited partnership units and amendments to the partnership agreement, among them an amendment to reduce the vote required for approval of conflict transactions from 66 2/3% of outstanding units to a majority, plaintiff's claims cited certain affiliate transactions (including a joint venture and a sale) that had been consummated in the months prior to the solicitation of the limited partner vote. In the original complaint, plaintiff alleged that fiduciary duties were breached by the partnership's entry into grossly unfair transactions and that the disclosures in the proxy materials in connection with the limited partner vote on the amendments to the partnership agreement were insufficient and misleading. Subsequent to the filing of the original complaint, the partnership made supplemental disclosures in public filings. For its part, the general partner filed a letter from its president and CEO, Jerry Thompson, to the unitholders of the partnership, outlining the benefits of the proposals and encouraging their approval and directing the unitholders to the previous proxy materials, together with a letter from Dan Duncan to Mr. Thompson, which Mr. Thompson described in his letter as representing Mr. Duncan's view of the proposals, as additional proxy materials. Mr. Duncan, in addition to being a director of the partnership and of the general partner, was a director of the general partner of a company with which the partnership had entered into a joint venture arrangement and to which the partnership sold its interest in a processing plant, as well as being the chairman of the company that provided management, administrative and operating services for the partnership and the general partner and for the company involved in the joint venture and sale transactions. Mr. Duncan also owned limited partnership units of the partnership, indirectly acquired the controlling interest in

the general partner and owned limited partnership units of the company involved in the joint venture and sale transactions. At a meeting following the supplemental disclosures, the owners of at least 66 2/3% of the outstanding units of the partnership approved the proposals. Plaintiff then amended the complaint to modify the disclosure claims given the additional filings, resting such claims on the information provided about the joint venture and sale transactions and on Mr. Duncan's letter as a one-sided portrayal of the general partner's proposals, and defendants moved to dismiss as described above.

The court denied the motion to dismiss the fiduciary duty claims, finding that the allegations in the complaint referring collectively to the directors of the general partner as responsible for approving certain affiliate transactions were adequate pleadings that put the directors on notice of the claims against them. The motion to dismiss the disclosure claims, however, was granted as to all defendants. As to such claims, the court noted that the violation must be material and that under Delaware law this standard requires that there exists a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable stockholder as having significantly altered the 'total mix' of information made available." (quoting *Loudon v. Archer-Daniels-Midland Co.*, 700 A.2d 135, 143 (Del. 1997)). Plaintiff had not claimed that materially false statements were made but rather alleged that there were actionable omissions and misleading partial disclosures. Plaintiff had attempted to connect the joint venture and sale transactions to the proposals based on the fact that an effect of the passage of the proposals would be that similar affiliate transactions would be easier to approve. The court determined that the proxy materials neither contained inadequate detail nor did they present a misleadingly good view of these prior transactions. Further, as to the information disclosed with respect to the proposals, the court declined to view Mr. Duncan's letter in isolation, as plaintiff had urged, and found that the material facts cited by plaintiff as being absent from the letter were part of the "total mix" of information available to unitholders before their vote, either in the original proxy statement or the supplemental materials. In reaching this decision, the court considered the content of the letters from Messrs. Duncan and Thompson, including the specific direction to review the proxy materials in the latter, and concluded that a reasonable unitholder would not have relied on the Duncan letter alone. As to the remaining allegation that the letter should have disclosed an intention to transfer the partnership's assets to affiliates, the court stated that the record did not support such an intention and that the disclosures sought by plaintiff would have been tantamount to Mr. Duncan implicating himself in future breaches of fiduciary duty.

16. *Cargill, Inc. v. JWH Special Circumstance LLC*, C.A. No. 3234-VCP (Del. Ch. Nov. 7, 2008)

This case involved breach of fiduciary duty claims against the managing owner (the "Managing Owner") of a Delaware statutory trust (the "Trust") and against Cargill Investor Services, Inc. ("CIS"), which was the parent of the Managing Owner, and Cargill, Inc. ("Cargill" and, together with CIS, the "Cargill Plaintiffs"), which was the parent of CIS. The claims arose from Cargill's sale of, among other things, control of the Managing Owner to Refco Group Ltd., LLC, a wholly owned subsidiary of Refco, Inc. (collectively, "Refco"). As a result of the Refco transaction, certain accounts of the Trust

were transferred to Refco and its affiliates. Soon after the Refco transaction, Refco became embroiled in a financial scandal that resulted in the bankruptcy of Refco and certain of its affiliates and consequently the loss of approximately \$35 million of the Trust's assets.

The Cargill Plaintiffs filed a declaratory judgment action in the Court of Chancery seeking, among other things, a declaration that the Cargill Plaintiffs did not owe any fiduciary duties to the Trust and a declaration that the Cargill Plaintiffs did not breach any fiduciary obligation to the Trust. JWH Special Circumstance LLC ("JWH") acted on behalf of the Trust in answering the complaint and asserting counterclaims against the Cargill Plaintiffs alleging, among other things, breaches of fiduciary duties owed to the Trust and aiding and abetting breaches of fiduciary duties by the Managing Owner. This opinion addressed the Cargill Plaintiffs' motion for judgment on the pleadings and motion to dismiss JWH's counterclaims.

JWH argued that the Cargill Plaintiffs breached fiduciary duties to the Trust and aided and abetted the Managing Owner's breach when they sold control of the Managing Owner to Refco without obtaining the consent of the unitholders of the Trust. Although the Trust Agreement contained an anti-assignment provision that applied to the Managing Owner, it did not contain a change of control provision that was broad enough to be triggered upon the sale of the equity of the Managing Owner. JWH alleged that the sale of the equity of the Managing Owner, in lieu of an assignment by the Managing Owner of its rights under the Trust Agreement to Refco, circumvented the requirement for unitholder approval under the Trust Agreement and that this circumvention constituted a breach of fiduciary duty. The court found that the sale of control of the Managing Owner did not breach the provisions of the Trust Agreement and that, in any event, neither of the Cargill Plaintiffs were a party to the Trust Agreement and therefore could not have breached the Trust Agreement. The court thus found no basis for JWH's fiduciary duty claims and dismissed JWH's "circumvention" allegation for failure to state a claim.

The court next addressed JWH's claims that the Cargill Plaintiffs breached their fiduciary duties as the parent and grandparent of the Trust, citing to the line of cases in the partnership context beginning with *In re USACafes, L.P., Litigation*. Under this line of cases, if a corporate parent of a fiduciary exercises dominion and control over the fiduciary in connection with a transaction that benefits the corporate parent at the expense of the underlying entity, the corporate parent may owe fiduciary duties directly to the underlying entity in connection with the transaction. JWH argued that under this line of cases, the Cargill Plaintiffs at least owed a duty of loyalty to the Trust because they caused the Managing Owner to consent to take actions in furtherance of Refco transaction for the benefit of the Cargill Plaintiffs at the expense of the Trust. The Cargill Plaintiffs argued that the *USACafes* line of cases is not applicable in the statutory trust context because, according to the Cargill Plaintiffs, the DTA preempts the application of common law fiduciary duties to statutory trusts and thus unless a trust agreement explicitly provides a corporate parent with fiduciary duties, it does not owe any fiduciary duties to the statutory trust. The court rejected this argument, holding that common law fiduciary duties apply to statutory trusts except (i) to the extent a trust's governing instrument provides otherwise and (ii) to the extent provided in the DTA.

The court then addressed whether the Trust Agreement or the DTA modified the common law fiduciary duties that would otherwise be owed by Cargill Plaintiffs to the Trust. The court stated that, like a corporate fiduciary, a fiduciary of a trust does owe a duty of care and a duty of loyalty under the common law. However, by virtue of Section 3809 of the DTA, which provides that, except to the extent otherwise provided in the governing instrument of a statutory trust or in the DTA, Delaware law pertaining to common law trusts applies to statutory trusts, the court stated that fiduciaries of statutory trusts are subject to the more rigorous standards associated with the common law duty of care and the duty of loyalty under trust law. After reviewing the provisions of the Trust Agreement, the court concluded that the Trust Agreement did not eliminate the common law fiduciary duties that the Cargill Plaintiffs may have owed to the Trust.

The court also examined whether the DTA itself preempts any common law fiduciary duties the Cargill Plaintiffs would otherwise have owed to the Trust. In support of their contention that they owed no fiduciary duties to the Trust, the Cargill Plaintiffs pointed to Section 3806(a) of the DTA for the proposition that an entity's exercise of power over the trust's manager does not cause such person to become subject to the fiduciary duties of a trustee. The third sentence of Section 3806(a) states, "Except to the extent otherwise provided in the governing instrument of a statutory trust, neither the power to give direction to a trustee or other persons nor the exercise thereof by any person (including a beneficial owner) shall cause such person to be a trustee." The court acknowledged that an entity's exercise of power over a trust's managing owner, in and of itself, does not subject that entity to the fiduciary duties of a trustee but held that this does not mean that Section 3806 of the DTA precludes a claim against a parent entity under the *USACafes* line of cases. The court rejected the Cargill Plaintiffs' interpretation of Section 3806(a) and found that the applicable language contained in the fourth sentence of Section 3806(a), which provides that "[t]o the extent provided in the governing instrument of a statutory trust, neither the power to give direction to a trustee or other persons nor the exercise thereof by any person (including a beneficial owner) shall cause such person to have duties (including fiduciary duties) or liabilities relating thereto to the statutory trust or to a beneficial owner thereof," requires that a provision be included in a trust instrument to override any fiduciary duties that those who have control over the managing owner might otherwise have under the trust law.

Having concluded that neither the Trust Agreement nor the DTA preempted the common law fiduciary duties owed by the Cargill Plaintiffs to the Trust, the court then considered whether the Cargill Plaintiffs in fact owed a duty to the Trust under the *USACafes* line of cases. The court noted that the *USACafes* line of cases arise from the law of trusts and found that the reasoning in these cases is applicable in the statutory trust context. Applying the law from these cases, the court stated that for JWH to defeat the pending motions it must have alleged specific facts that lead to a reasonable inference that the Cargill Plaintiffs exercised control over the Trust or its assets in connection with the Refco transaction to benefit themselves at the expense of the Trust. The court found that the facts alleged by JWH were sufficient to support such an inference and therefore denied the Cargill Plaintiffs' motions to dismiss the breach of fiduciary duty claims.

The court then turned to JWH's claims for aiding and abetting the Managing Owner's breach of fiduciary duty. To successfully prove an aiding and abetting claim, the court stated that JWH would have to have shown (i) the existence of a fiduciary relationship; (ii) the fiduciary breached its duty; (iii) a defendant, who is not a fiduciary, knowingly participated in a breach; and (iv) damages to the plaintiff resulted from the concerted action of the fiduciary and the nonfiduciary. The court found that the Managing Owner was a fiduciary of the Trust and that JWH's allegations were sufficient to allege breaches of the Managing Owner's fiduciary duties of care and loyalty based on the Managing Owner's conduct in connection with Refco transaction. The court also found that JWH sufficiently alleged that the Cargill Plaintiffs knowingly participated in the breach and that damages resulted from the actions of the Cargill Plaintiffs and the Managing Owner. The motion to dismiss the aiding and abetting claims were thus denied.

17. *Olson v. Halvorsen*, C.A. No. 1884-VCL (Del. Ch. Oct. 22, 2008); and *Olson v. Halvorsen*, C.A. No. 1884-VCL (Del. Ch. May 13, 2009)

Plaintiff was one of three founding partners of an investment management firm and hedge fund known as Viking Global ("Viking"). Viking was initially comprised of three Delaware entities, each of which was governed by a written operating agreement. At plaintiff's insistence, a fourth Delaware entity was formed a few months later called Viking Global Founders LLC ("Founders"). No short-form LLC agreement was ever drafted for Founders. A long-form LLC agreement was drafted but never signed. This unsigned LLC agreement was drafted primarily by plaintiff and included a multi-year earnout provision not found in any of the other operating agreements. According to its terms, any of the three founders who voluntarily or involuntarily retired from Viking would be entitled to a percentage of Founder's income over the six years following his retirement. This provision diverged significantly from the withdrawal provisions in each of the other operating agreements, which provided that a departing member was entitled only to the balance of his capital account and accrued compensation upon leaving the firm.

Plaintiff was subsequently removed from his position at Viking and paid over \$100 million, which amount represented his capital account balance and accrued compensation as called for under the terms of each of the written operating agreements. Plaintiff brought suit seeking, among other things, enforcement of the earnout provision in the unsigned Founders LLC agreement. Defendants disputed plaintiff's claim, arguing that they had never reached an agreement on the terms of the unsigned Founders LLC agreement. Both parties moved for summary judgment.

The primary issue before the court, and a matter of first impression in Delaware, was whether the statute of frauds applied to LLC operating agreements under Delaware law. In considering the issue, the court acknowledged that the Delaware LLC Act expressly allowed oral LLC agreements but noted that it did specify whether the statute of frauds applied to such agreements. The court noted that there was a disagreement among commentators as to whether the statute of frauds applied to the operating agreements of Delaware LLCs. Some commentators reasoned that without an express, specific indication of intent to overrule a statutorily enacted principle of contract law, the

principle should apply. Others argued that the stated policy of the LLC Act to give maximum effect to the enforceability of LLC agreements, along with the express authorization of oral operating agreements, created an inference that the legislature intended to override the statute of frauds. The court ultimately concluded that the policy for the enactment of the statute of frauds—to protect defendants against unfounded or fraudulent claims that would require performance over an extended period of time—called for the application of the statute of frauds to LLC agreements if an LLC agreement contains a provision or multiple provisions that could not possibly be performed within one year, with the result that such provision or provisions would be unenforceable. However, the court went on to state that in keeping with the legislature’s expressed intent to give maximum effect to the enforceability of limited liability companies, provisions of an oral LLC operating agreement that could possibly be performed within one year would not fall within the statute of frauds and would remain enforceable. The court also asserted that few oral LLC agreements were likely to contain any term or provision that could not possibly be performed within one year and, to that extent, the statute of frauds would not limit the enforcement of such agreements.

Having determined that the statute of frauds applied to LLC agreements, the court went on to conclude that the earnout provisions at issue in the unsigned Founders LLC agreement were subject to the statute of frauds because none of them could possibly be performed within one year. In reaching this conclusion, the court rejected plaintiff’s argument that the statute of frauds did not apply because the only thing that remained to be done after one year was the payment of money. The court held that it was undisputed that, in addition to the payment of money, the unsigned Founders LLC agreement imposed substantive obligations and restrictions on the remaining members that would affect how they chose to run the business over a multi-year period. The court also held that the “multiple writings” and “part performance” exceptions argued by plaintiff did not apply to the facts of the case to remove the unsigned Founders LLC agreement from the statute of frauds. Thus, the court granted summary judgment as to plaintiff’s breach of contract claim.

In a subsequent decision in this case, plaintiff sought fair value for his interests in various Delaware entities. Based on Section 17-604 of DRULPA and Section 18-604 of the LLC Act, the court held that where a valid and enforceable agreement of the parties conflicts with the applicable fair value statute, the agreement of the parties will govern. Thus, plaintiff was not entitled to fair value for his interests in the Viking entities because the parties had previously reached an oral agreement that conflicted with the fair value statutes by providing that a member would only take his accrued compensation and capital account balance upon leaving Viking. While this agreement was refined by subsequent written agreements for three of the four Viking entities, all of which were consistent with this limitation, the court found that it continued to apply to Founders as the original agreement governing its operation and constituted an enforceable oral limited liability company agreement because it was possible that it could be completed in the span of one year. Additionally, the court held that plaintiff failed to prove the existence of any superseding agreement that conflicted with the parties’ oral agreement and, therefore, the plaintiff was entitled to the balance of his capital account and accrued compensation but nothing further.

As an alternative to his fair value claim, plaintiff sought damages based on theories of promissory estoppel, civil conspiracy, unjust enrichment and breach of fiduciary duty. However, the court held that plaintiff failed to prove any of the required elements of his estoppel claims and entered judgment in favor of defendants. With respect to plaintiff's other claims, the court held that they similarly failed because plaintiff failed to show deprivation of value to which he was entitled. According to the court, the operating agreements of the Viking entities uniformly provided that a departing member or partner would receive only his accrued compensation and capital account upon departure and, therefore, plaintiff, having already received such amounts, was entitled to no more.

18. *In re Seneca Invs. LLC*, C.A. No. 3624-CC (Del. Ch. Sept. 23, 2008)

Petitioner, a member and the former CEO of a Delaware LLC filed a petition seeking judicial dissolution of the LLC, alleging that since his removal as CEO the LLC had not had a business plan and had not made any investments, sought or received any additional capital, held any director or member meeting or sought to hire anyone to conduct the business of the LLC. The LLC's operating agreement provided that, subject to certain exceptions, the "[LLC] will be governed in all respects as if it were a corporation organized under and governed by the Delaware General Corporation Law . . . and the rights of its Stockholders will be governed by the DGCL." Petitioner thus sought judicial dissolution of the LLC under both Section 18-802 of the LLC Act and Section 226(a)(3) of the Delaware General Corporation Law (the "DGCL"). In this opinion, the Court of Chancery addressed the LLC's motion for judgment on the pleadings.

Under Section 18-802 of the LLC Act, the Court of Chancery may decree dissolution "whenever it is not reasonably practicable to carry on the business in conformity with a limited liability company agreement." Based on the lack of extensive case law interpreting Section 18-802 of the LLC Act, the court looked to case law involving judicial dissolution of limited partnerships and observed that judicial dissolution has been ordered where there was a "deadlock" that prevented a company from operating and where the defined purpose of the company was fulfilled or impossible to carry out. The court stated that since there is no allegation of a deadlock, the inquiry must focus on whether it is impracticable for the LLC to fulfill its business purpose. To determine whether it was reasonably practicable to carry on the business of the LLC, the court looked to the purpose clause set forth in the governing document of the LLC, which provided that the LLC could "engage in any lawful act or activity for which corporations may be organized under the [DGCL]." Because petitioner alleged that the LLC was functioning as a passive instrumentality, which is a function that is both lawful and common for an LLC, the court found that petitioner had not alleged sufficient facts to support a claim that it is not reasonably practicable for the LLC to carry on business in conformity with its operating agreement. The court stated that it will not attempt to divine some other business purpose by interpreting provisions of the LLC's governing documents other than the purpose clause. In addition, the court rejected petitioner's further argument that the court should order judicial dissolution of the LLC because the LLC had allegedly failed to comply with the certain provisions of its operating agreement, including, for example, failing to make required cash distributions. The court stated that violations of an operating agreement are not necessarily grounds to order

dissolution. The court also noted that the LLC had filed several counterclaims, including claims for conversion and unjust enrichment, against petitioner, and under Delaware case law, a non-deadlocked LLC pursuing claims is a legitimate business activity that can defeat a petition for dissolution.

Because the LLC had elected to be governed by the DGCL, the court also analyzed whether dissolution could be warranted under Section 226(a)(3) of the DGCL. Under Section 226(a)(3) of the DGCL, the Court of Chancery has the power to appoint a custodian or receiver for a corporation when the “corporation has abandoned its business and has failed within a reasonable time to take steps to dissolve, liquidate or distribute assets.” The court again looked to the LLC’s purpose clause and observed that a corporation can lawfully function as a passive holding company. Citing prior case law, the court stated that “waiting to see if an opportunity presents itself to realize a return on its investment” is “a rational, lawful use of the corporate form.”

Finally, the court addressed petitioner’s claim that the LLC cannot take any action other than liquidation because a provision of its operating agreement provides that “[d]istributions of available cash for any Fiscal Year shall be made to the Stockholders in accordance with the number of Common Shares held by each.” The court acknowledged that a court should not decide between reasonable interpretations of a contract provision on a motion for judgment on the pleadings; however, the court found petitioner’s interpretation of the foregoing provision was not reasonable and thus dismissed the petition for judicial dissolution.

19. *EBG Holdings LLC v. Vredezicht’s Gravenhage 109 B.V.*, C.A. No. 3184-VCP (Del. Ch. Sept. 2, 2008)

Plaintiff, a Delaware LLC, sued Vredezicht’s Gravenhage 109 B.V. (“VG 109”), a Dutch private limited liability company, and its parent, NIBC Bank N.V. (“NIBC”), also a Dutch entity, for breach of VG 109’s obligation under the LLC Agreement to reimburse the LLC for payments relating to withholding tax the LLC made on VG 109’s behalf. In this decision, the Chancery Court addressed NIBC’s motion to dismiss for lack of personal jurisdiction over NIBC.

The LLC was formed in a restructuring transaction in which a lending group, which included NIBC, swapped its debt in an entity for equity in the LLC. NIBC designated VG 109 as the entity to acquire its portion of the equity in the LLC. VG 109 was a wholly owned subsidiary of NIBC, with the same business address as NIBC, with no employees or officers of its own, and without letterhead or envelopes of its own. NIBC was the managing director of VG 109 and NIBC’s employees signed documents on behalf of VG 109. VG 109 signed the original LLC Agreement of the LLC as a member. The LLC Agreement identified NIBC as a “Designating Lender” affiliated with VG 109 but NIBC did not sign the LLC Agreement and was not a member of the LLC.

The LLC first argued that NIBC was subject to the Chancery Court’s jurisdiction directly, via Delaware’s long arm statute, arguing that by participating in the formation of the LLC, it had thereby transacted business or performed work within Delaware. Plaintiff

cited to case law providing that the incorporation and operation of a Delaware subsidiary constitutes the transaction of business in Delaware. The court rejected this argument as too attenuated, especially because the LLC had failed to demonstrate that it was a subsidiary of either defendant. In fact, VG 109 held only a minority interest in the LLC and did not control the LLC. In addition, the court found the act of formation of the LLC was not fundamental to the underlying dispute.

The LLC also argued that NIBC had consented to jurisdiction in Delaware pursuant to a clause in the LLC Agreement under which the parties to the LLC Agreement consented to the personal jurisdiction of the Delaware courts. While agreeing that parties may consent to personal jurisdiction via contract, the court rejected this argument because NIBC was not a signatory to the agreements.

Finally, the LLC claimed that the court had personal jurisdiction over NIBC indirectly through VG 109, which had consented to personal jurisdiction in Delaware, under the agency theory and the alter ego theory. The court refused to impute the contractual consent to jurisdiction by VG 109 to NIBC, stating that because the LLC Agreement was negotiated by sophisticated parties and included a consent to jurisdiction by the parties, but not their affiliates, the court would not accept the LLC's attempt to circumvent the parties' intention under the guise of an agency argument. The court also stated that a minority, passive investor in a Delaware LLC who allegedly breaches the LLC agreement in a manner that affects only the LLC and its members is not subject to Delaware's long-arm statute for the alleged breach without a showing that the investor in the LLC took additional action from which the asserted cause of action arose to consciously take advantage of the laws of Delaware. On this basis, the court held that, even if all of the actions of VG 109 in this case were imputed to NIBC, those actions still would not provide a sufficient basis for subjecting NIBC to personal jurisdiction in Delaware. The court thus granted NIBC's motion to dismiss for lack of personal jurisdiction.

In reaching its decision in this case the court commented that "VG 109's execution of the Amended LLC Agreement, as a fundamental governance document, conceivably could supply a basis for personal jurisdiction in this Court." The court stated that the execution and alleged breach of an LLC agreement presents interesting jurisdiction questions, since the LLC agreement itself is a "jurisdictional hybrid." It is similar to a certificate of incorporation, in that it is a foundational document controlling the entity's governance, thereby relating to the very nature of the entity, so that manipulation of the governance provisions could be a basis for jurisdiction. On the other hand, the LLC Act and the Delaware courts have emphasized that when dealing with LLC agreements, freedom of contract is paramount, which draws the conclusion that such agreements "also may contain provisions that do not implicate the fundamental attributes and workings of a Delaware entity." However, because the provision in the LLC Agreement on which this cause of action was based was a collateral provision that did not significantly affect plaintiff's operation under Delaware law, the court did not find it necessary to delve further into this issue.

20. *R&R Capital, LLC v. Buck & Doe Run Valley Farms, LLC*, C.A. No. 3803-CC (Del. Ch. Aug. 19, 2008)

Plaintiffs sought judicial dissolution under Section 18-802 of the LLC Act or in the alternative the winding up under Section 18-803 of the LLC Act or the appointment of a receiver under Section 18-805 of the LLC Act of nine Delaware LLCs. The Delaware LLCs were managed by an individual manager who was not made a party to the lawsuit. The respondent LLCs moved to dismiss the petition and made two arguments in support of their motion. First, in support of their motion to dismiss with respect to two of the nine LLCs (the “Pandora Entities”), respondents argued that petitioners lacked standing to seek the dissolution or winding up of the LLCs under Sections 18-802 or 18-803 of the LLC Act because both sections by their terms only permit members and managers to act and petitioners were neither members nor managers of the Pandora Entities and therefore lacked standing. The court agreed and dismissed petitioners’ claims under Section 18-802 and 18-803 of the LLC Act. Petitioners also sought the appointment of a receiver for the Pandora Entities under Section 18-805 of the LLC Act, which provides that any “creditor, member or manager of the limited liability company, or any other person who shows good cause” may seek the appointment of a receiver. The court found that respondents did not challenge petitioners’ ability to seek relief under Section 18-805 of the LLC Act and therefore denied the motion with respect to Section 18-805 of the LLC Act.

Petitioners were members of the other seven Delaware LLCs (the “Waiver Entities”) and therefore there was no question that they had standing to seek relief under Sections 18-802, 18-803 and 18-805 of the LLC Act. Respondents argued that pursuant to the applicable LLC agreement of each of the Waiver Entities (the “LLC Agreements”), petitioners waived their right to seek dissolution or appointment of a liquidator. Petitioners conceded that the contractual language in the applicable LLC agreements purported to effect a waiver of such rights but nevertheless argued that the waiver was invalid as a matter of law. The court, however, rejected this argument and granted respondents’ motion with respect to the Waiver Entities. The court began its analysis by observing that the policy behind the LLC Act is to provide the parties involved with the maximum amount of freedom of contract, private ordering and flexibility. The court noted that petitioners obviously availed themselves of this flexibility to tailor the respective LLC Agreements in such a way as to meet each LLC’s needs including by providing for a waiver of members’ rights to seek dissolution or the appointment of a liquidator. In support of their argument that the waiver provisions contained in each of the LLC Agreements were unenforceable as a matter of law, petitioners first argued that Section 18-109(d) of the LLC Act stood for the proposition that “non-managing members may not waive their rights to maintain legal actions in Delaware courts absent an agreement to arbitrate.” Thus, because petitioners were non-managing members and had not agreed to arbitrate, the waiver provision violated the statute and was therefore void. The court rejected this argument, finding that Section 18-109(d) was essentially a venue provision. The court went on to state that if the statute were interpreted in the manner asserted by petitioners, the LLC Act would conflict with itself and the rules of statutory construction would caution against such a conclusion.

Petitioners' second argument was that certain provisions of the LLC Act, including those governing judicial dissolution or the appointment of a receiver were mandatory and non-waivable. In support of this proposition, petitioners argued that any "statutory provisions that did not contain the qualification 'unless otherwise provided in a limited liability company agreement (or a variation thereof)' are mandatory and may not be waived." In rejecting this broad rule offered by petitioners, the court noted that in general the mandatory provisions of the LLC Act are those that are intended to protect third parties, not the contracting members. Additionally, the use of the word "may" indicates the "voluntary, not mandatory or exclusive, set of options." Thus, the court found that sections 18-802, 18-803 and 18-805 of the LLC Act were not mandatory for three reasons. First, the LLC Act does not expressly say that these provisions cannot be modified by agreement. Second, the provisions employ permissive rather than mandatory language in that each provision uses the auxiliary verb "may" to indicate the options of the court under the subject provisions. Third, and the court stated most importantly, none of the rights conferred by the applicable statutory provisions were designed to protect third parties.

Petitioners also argued that the waiver of a member's right to seek dissolution or the appointment of a receiver violated the public policy of Delaware and offended notions of equity. The court also rejected this argument for three reasons. First, the court reasoned that the LLC Act was based on the policy of freedom of contract and allowing the members of an LLC to order their affairs contractually as they deemed appropriate. Further, Delaware as a freedom of contract state has a policy of enforcing the voluntary agreement of sophisticated parties, such as those party to the LLC Agreements. Thus, because the LLC Agreements were among sophisticated parties, the court concluded that the state's policy "mandates that [the] Court respect and enforce the parties' agreement." Second, the court reasoned that there are legitimate business reasons why members of an LLC would want to include a provision whereby members prospectively waive their right to seek dissolution or the appointment of a receiver in its LLC agreement. For example, a lender under a loan agreement may require an LLC prospectively to agree to waive their rights to judicial dissolution to protect the LLC, otherwise a disgruntled member could push the LLC into default on all of its outstanding loans simply by filing a petition with the court. Third, the court found petitioners' plea to the court's sense of equity misplaced, finding that the LLC Act did not leave petitioners without any recourse. The court emphasized that the LLC Act prohibits parties from waiving the implied covenant of good faith and fair dealing and it is the protection of the "implied covenant that allows the vast majority of the remainder of the LLC Act to be so flexible."

21. *Pharmalytica Services, LLC v. Agno Pharms., LLC*, C.A. No. 3343-VCN (Del. Ch. July 9, 2008)

Plaintiff, a Delaware LLC, filed suit against defendants for breach of fiduciary duty, equitable and legal fraud, and breach of plaintiff's LLC agreement. The lawsuit was based upon actions by defendant James Chen ("Chen"), who was ousted from the management team and his positions as CEO and president of plaintiff when the other members discovered that he had formed a competitive entity that was pursuing business opportunities that otherwise would have been available to plaintiff. Although Chen

objected to the calling of the meeting and did not attend, a quorum was present and a unanimous vote taken in favor of a resolution removing Chen from these positions. In connection with the lawsuit, plaintiff allegedly discovered that Chen had made modifications to its draft operating agreement after circulating the draft to the other members, which went unnoticed when the members later signed the agreement into effect, as modified. These changes, in part, gave Chen as CEO the power unilaterally to appoint and approve personnel to plaintiff's or any joint venture's board of directors or management team.

This opinion arose out of a motion filed by plaintiff for a preliminary injunction against Chen when it was discovered that he was asserting plaintiff's rights in China to appoint designees to the board of a joint venture established between plaintiff and another company. Chen was apparently using a "Certificate of Appointment," which identified him as the legal representative and CEO of plaintiff, to authorize these actions. Plaintiff's asserted justifications for a preliminary injunction to halt these activities were that Chen had no authority to represent the plaintiff, his conduct was antithetical to the plaintiff's interests, and he was duly and properly removed from any office within the plaintiff thereby making unauthorized his current efforts, which justifications were supported by the allegedly fraudulently inserted terms in the operating agreement. Defendants responded that the efforts to remove Chen from office failed primarily because the operating agreement required a unanimous vote of the board of directors for any "major decisions," which was rendered impossible by Chen's absence from the meeting.

Although plaintiffs sought a preliminary injunction, the court found that the relief sought more closely resembled that recoverable under Section 18-110 of the LLC Act, the companion section to Section 225 of the DGCL. Under that section, a venture may continue to operate according to the "status quo," with minimal disruption, while the identity of those individuals who are appropriate holders of corporate power are established. The court noted that the traditional analysis under those sections does not typically apply the formalistic test for a preliminary injunction; however, because plaintiff had presented its claim under this framework, the court in this case adhered to the preliminary injunction standards.

First, the court found that plaintiff had demonstrated a reasonable probability of success on the merits of its claim that Chen should not be acting on plaintiff's behalf because his recent actions in China were inconsistent with the reasonable expectations of the other members of plaintiff. Next, the court found the record to show that Chen's conduct without plaintiff's authority was likely to cause significant and irreparable harm to plaintiff. Finally, the court agreed with plaintiff that when the harms were balanced, the risks to plaintiff were obvious and material, whereas the potential harm to Chen was minimal. For these reasons, the court granted a status quo order to plaintiff prohibiting Chen and the other defendants, pending final resolution of the merits, from taking any action on behalf of the plaintiff and from holding themselves out, individually or collectively, as representatives of plaintiff with any power to act on its behalf.

22. *Wood v. Baum*, C.A. No. 2404 (Del. July 1, 2008)

Plaintiff appealed the Court of Chancery’s decision to dismiss her derivative action on behalf of Municipal Mortgage & Equity, LLC (the “LLC”). The LLC was managed by a ten-member Board of Directors (the “Board”), of which eight were independent and two were inside directors. Plaintiff claimed the members of the Board, and one former member, breached their fiduciary duties by (a) improperly valuing certain assets which allegedly resulted in false financial statements, (b) making improper charitable contributions to conceal the deterioration of the LLC’s bond portfolio, (c) engaging in related-party transactions to inflate the LLC’s financial performance and (d) “fail[ing] properly to institute, administer and maintain adequate accounting and reporting controls, practices and procedures” The Court of Chancery had dismissed the complaint for failure to allege particularized facts sufficient to establish that demand on the Board would have been futile in accordance with Court of Chancery Rule 23.1.

Applying Delaware corporate law principles, by analogy, the Delaware Supreme Court highlighted that a stockholder may not pursue a derivative suit against a corporation unless the stockholder: (a) has first demanded that the directors pursue the corporate claim and the directors have wrongfully refused to do so; or (b) establishes that pre-suit demand is excused because the directors are deemed incapable of making an impartial decision regarding the pursuit of the litigation. In this instance, plaintiff sought to establish demand futility. Accordingly, to satisfy demand futility under Court of Chancery Rule 23.1, plaintiff had to satisfy either the *Aronson* test for those claims contesting a transaction that allegedly arose out of a conscious business decision in breach of the directors’ fiduciary duties, or the *Rales* test for those claims that the Board violated its oversight duties. Under *Aronson*, a plaintiff must allege particularized facts creating a reason to doubt that (1) the directors were disinterested or independent or that (2) the challenged transaction was otherwise the product of a valid exercise of business judgment. Under *Rales*, a plaintiff must allege particularized facts establishing a reason to doubt that “the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand.”

The gravamen of plaintiff’s complaint alleged that the Board could not exercise valid business judgment because of a substantial risk of personal liability. The court noted that the operating agreement of the LLC included a provision that exempted directors from liability “except in the case of fraudulent or illegal conduct” The court also cited Section 18-1101(e) of the LLC Act which permits an LLC to “provide for the limitation or elimination of any and all liabilities . . . for breach of duties (including fiduciary duties) of a [director],” except that an LLC “may not eliminate liability for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing.” The court stated that where directors are contractually or otherwise exculpated from liability, and a plaintiff alleges demand futility based on risk of personal liability to the directors, then a plaintiff must plead a *non-exculpated* claim based on particularized facts. Because the members of the Board were exculpated except for “fraudulent,” “illegal” or “bad faith” conduct, the court also required plaintiff to plead that the members had “knowingly” engaged in “fraudulent” or “illegal” conduct or a “bad faith” breach of the covenant of good faith and fair dealing. The court observed that

plaintiff failed to plead sufficiently that the Board had knowledge and plaintiff's allegations that the Board made affirmative misrepresentations in the financial statements of the LLC were also not sufficient. The Board's execution of financial reports, without more, was insufficient to create an inference of actual or constructive notice of any illegality. The court also rejected plaintiff's assertion that Board approval of a transaction or membership on a company's audit committee was sufficient to infer culpable knowledge or bad faith. Accordingly, the court affirmed the Court of Chancery's decision that the Board's approval of the financial reports, without more, was insufficient to create an inference either that (i) each member of the Board knew that the alleged transactions were improper or that (ii) the Board consciously and in bad faith failed to discharge fiduciary contractual responsibilities with respect to those transactions.

Plaintiff also claimed the Board knowingly ignored "red flags." Under Delaware law, the court stated, red flags "are only useful when they are either waved in one's face or displayed so that they are visible to the careful observers." In this case, there were no cognizable "red flags" to infer that the Board knew certain accounting requirements were being improperly applied.

Finally, the court also held that the complaint did not purport to allege a "bad faith violation of the implied contractual covenant of good faith and fair dealing." In this regard, the court stated that such covenant applies to protect stockholders' expectations that the company and its board will properly perform contractual obligations under the organizational documents, including the operating agreement. Here, the complaint did not allege any contractual claims let alone a bad faith breach of the implied covenant.

23. *Marie Raymond Revocable Trust v. MAT Five LLC*, C.A. No. 3843-VCL (Del. Ch. June 26, 2008); and *Marie Raymond Revocable Trust v. MAT Five LLC*, C.A. No. 3843-VCL (Del. Ch. Dec. 19, 2008)

Plaintiffs, who were investors in a Delaware limited liability company operating as a private hedge fund (the "Company"), filed a class action against the Company and its management claiming breaches of fiduciary duty for failing to adequately disclose material information necessary for investors to adequately assess their options under a tender offer by the Company to repurchase interests in the Company. The tender offer followed a significant infusion of capital into the Company by an affiliated entity, which became necessary due to a severe decrease in the value of the Company's assets. The tender offer offered the investors monetary and other financial consideration for their interests but required the tendering investors to release defendants from all legal claims directly or indirectly arising from the operation, management, supervision and investment of the Company's assets. This decision addressed plaintiffs' motion to expedite the proceedings based on allegations that the exchange memorandum delivered in connection with the tender offer contained material omissions.

Plaintiffs claimed that the exchange memorandum failed, among other things, to disclose the manner in which the equity in the Company received by the affiliated entity in consideration for its capital infusion was valued or to provide information on the nature

of claims investors were being asked to release. Defendants responded with several arguments, none of which the court found convincing. Among defendants' arguments was an argument that plaintiffs could not demonstrate a colorable claim because the information they sought was not material. The court stated that in order to state a claim for breach by omission of the duty to disclose, a plaintiff must plead facts identifying material, reasonably available information that was omitted from the proxy materials and further stated that omitted information is material if a reasonable stockholder would consider it important in deciding whether to tender his shares or would find that the information has altered the total mix of information available. In this case, the court held that plaintiffs had articulated a colorable claim for breach of the duty of disclosure, finding that how the Company's assets were valued and the nature of the claims being released, including a description of an SEC investigation, would alter the "total mix of information" and that a reasonable shareholder would consider this information important in deciding whether to accept the tender offer. The court thus granted plaintiffs motion to expedite the proceedings.

Following the grant of the motion to expedite proceedings, the court conducted a preliminary injunction in which it held that the disclosures in the exchange memorandum were insufficient and that the tender offer would be enjoined if not supplemented. Three months later, the parties entered into a memorandum of understanding that included terms of a settlement. As part of the settlement, the Company issued a revised exchange memorandum and tender offer that included significantly more disclosure, increased the monetary consideration for investors and expanded the options offered to investors. In a subsequent opinion, the court, among other things, analyzed the adequacy of the settlement and held it to be fair and reasonable.

24. *Donohue v. Corning*, C.A. No. 3733-VCS (Del. Ch. June 20, 2008)

Plaintiff, following his removal for cause as a managing partner, chairman of the board and a managing member of a Delaware LLC (the "Company") sought advancement of legal fees and expenses incurred in a legal proceeding that he initiated to challenge his removal, alleging that there was no "cause." In ruling on a motion by plaintiff for summary judgment, the Chancery Court addressed the issue of whether the Company's LLC Agreement provided plaintiff with a right to advancement for an action he brought to contest his removal. The court denied plaintiff's motion, finding that the relevant provision of the Company's LLC Agreement provided advancement only for the defense or other defensive disposition of an actual or threatened proceeding and that, because defendants did not threaten or initiate a proceeding against plaintiff, he is not entitled to advancement.

The relevant provision of the Company's LLC Agreement that plaintiff looked to in support of his claim for advancement provided in part that: "the Company shall indemnify and hold harmless . . . the Covered Persons from and against all liabilities and expenses . . . incurred in connection with the defense or disposition of any claim, action, suit, or proceeding . . . with which the Covered Person may be threatened . . ." The court determined that the best reading of the advancement provision is that it was meant to apply only in situations in which a suit has been brought against or threatened against a

person entitled to indemnification under the Company's LLC Agreement. Plaintiff argued that his removal for cause, which was based on an alleged breach of his fiduciary duties to the Company, constituted a threat of a proceeding against him. The court found, however, that defendants, who were clearly aware of the contours of the advancement provision, never actually threatened to bring an action for breach of fiduciary duty against plaintiff or otherwise took actions that could reasonably be interpreted as a threat of a proceeding and that the removal of plaintiff was the only consequence defendants intended to attach to the actions they alleged constituted "cause." The court thus held that plaintiff was not entitled to advancement because he could not identify a threatened "claim, action, suit or proceeding" and therefore denied his motion for summary judgment. In rendering its decision, the court noted that the LLC Agreement provided an adequate incentive for members and former members to bring meritorious suits to enforce their contractual rights under the LLC Agreement by requiring the losing party in such a suit to pay the fees and costs of the prevailing party.

25. *Schuss v. Penfield Partners, L.P.*, C.A. No. 3132-VCP (Del. Ch. June 13, 2008)

Plaintiffs, who had withdrawn as limited partners of a hedge fund formed as a Delaware limited partnership, claimed that the non-pro rata in-kind distribution they received from the hedge fund in respect of their withdrawal violated the partnership agreement and Section 17-605 of the LP Act. This decision addressed a motion to dismiss by defendants.

As a preliminary matter, defendants argued that because the hedge fund is not a party to its own partnership agreement and is not alleged to have caused a breach of the partnership agreement, the hedge fund cannot be liable for breach of the partnership agreement. The court held that, because Section 17-606(a) of the LP Act makes it clear that it is the partnership that owes the distribution to the limited partners, the hedge fund is a proper defendant. [Note: The court presumably could have also cited to the definition of "partnership agreement" in Section 17-101(12) of the LP Act, which provides that a limited partnership is bound by its partnership agreement whether or not the limited partnership executes the partnership agreement.]

Section 17-605 of the LP Act provides in relevant part that, except as provided in a partnership agreement, a partner may not be compelled to accept a distribution in kind to the extent that that the percentage of the asset distributed exceeds a percentage of that asset which is equal to the percentage in which the partner shares in distributions from the partnership. The hedge fund's partnership agreement provided that distributions to withdrawing partners "shall be made in cash or, in the sole discretion of the General Partner, in securities selected by the General Partner or partly in cash and partly in securities selected by the General Partner." Plaintiffs acknowledged that Section 17-605 can be overridden by a partnership agreement but alleged that the language in the hedge fund's partnership agreement was not sufficient to do so. Although the partnership agreement did not explicitly permit non-pro rata in-kind distributions, the court held that the broad discretion given to the general partner to determine which, if any, securities to distribute in kind and whether to make a distribution entirely in kind, even if the fund also has cash assets, was sufficient to override the default rule of Section 17-605. The

court therefore held that the hedge fund was permitted to make non-pro rata in-kind distributions and dismissed this claim.

The court also addressed the parties' dispute as to whether the withdrawing partners were entitled to a distribution of the securities specified by the general partner for distribution to the withdrawing partners at the time of withdrawal, even if those securities had declined in value between the time of withdrawal and the time when the securities were actually distributed, or, alternatively, to assets whose aggregated value at the time of distribution equaled the withdrawing partners' share of the hedge fund as of the time of withdrawal. Under the partnership agreement, the hedge fund was required to make distributions to a withdrawing partner within thirty days of its withdrawal in an amount equal in value to not less than 90% of the estimated amount of the withdrawing partner's capital account balance as of the withdrawal date. Plaintiffs argued that they are entitled to a distribution in an amount equal to the value of their capital account balance as of the withdrawal date, which becomes a fixed amount as of the withdrawal date. The court held that plaintiffs had at least a colorable claim that the plain language of the partnership agreement supported their argument and, accordingly, denied defendants' motion to dismiss this claim.

Plaintiffs also claimed the general partner breached its fiduciary duties to the withdrawing partners by taking the actions set forth above. On the basis of the court's holding that plaintiffs might succeed in proving that defendants' interpretation of the partnership agreement was incorrect with respect to determining the value of the distribution to which plaintiffs' were entitled, the court denied defendants' motion to dismiss this claim. Defendants also argued that the fiduciary duties claims should be dismissed because they were duplicative of the breach of contract claims. The court disagreed, holding that although each of the claims shared a common nucleus of operative facts, the fiduciary duty claims depended on additional facts, were broader in scope, and involved different considerations in terms of a potential remedy.

Finally, plaintiffs demanded an accounting. The court set forth several factors that are typically examined when considering a demand for an accounting, which include whether: (i) the partner was wrongfully excluded from the partnership; (ii) there is a breach of fiduciary duty; and (iii) other circumstances render an accounting just and reasonable. Based on the complexity of the allegations regarding improper distributions and the nature of the wrongs alleged, the court denied defendants' motion to dismiss plaintiffs' demand for an accounting.

26. *Maitland v. Int'l Registries, LLC, et al.*, C.A. No. 3669-CC (Del. Ch. June 6, 2008)

In an action under Section 18-305 of the Delaware LLC Act for inspection of the books and records of two different limited liability companies, plaintiff filed two motions. Plaintiff's first motion sought to strike an answer filed by one of the defendant companies ("Vienna") and disqualify Vienna's counsel. The second motion was for a commission requesting documents and deposition testimony from the outside auditing firm of the second defendant company.

Plaintiff was one of two members and a fifty percent interest holder of Vienna and, as such, claimed that Vienna was not authorized to file an answer and hire counsel without plaintiff's consent. Section 7 of Vienna's LLC agreement provided that the decision of the members holding a majority interest shall be controlling. Section 7 went on to state that the members were "granted all rights, powers, authorities, and authorizations necessary, appropriate, and advisable and/or convenient to manage [Vienna] and to determine and carry out its affairs." The court held, however, that while this provision may allow for one member to act unilaterally where the other is silent, where the members disagree, the quoted language does not trump the language providing that decisions of the majority are controlling. Recognizing that the dispute between plaintiff and Vienna was essentially a dispute between plaintiff and the other member, the court went on to state that, although plaintiff's motion to strike the answer and disqualify counsel would be granted, the second member was expressly permitted to intervene as a party defendant with authority to defend on behalf of Vienna.

The court denied plaintiff's second motion for a commission, citing Chancery Court Rule 26, which restricts discovery to matters relevant to the subject matter involved. The court stated that to grant such a sweeping request would effectively grant plaintiff its final relief--the books and records ultimately at issue. Thus, because there was no showing that the requested commission was for materials relevant to the narrow issue at hand, the motion was denied.

27. *Venhill Ltd. P'ship. v. Hillman*, C.A. No. 1866-VCS (Del. Ch. June 3, 2008)

Plaintiffs were Venhill Limited Partnership ("Venhill"), a Delaware limited partnership created to serve as an investment vehicle for the benefit of the families of Howard Hillman ("Howard") and Tatnall Hillman ("Tatnall"), and two trusts (the "Trusts") that were limited partners in Venhill. Howard, the principal defendant, served as general partner of Venhill, and Howard, Tatnall and Joe Hill ("Joe"), a cousin, were the three trustees for the Trusts. The litigation related to the substantial investments Howard had caused the Trusts, through Venhill, to make in Auto-trol ("Auto-trol"), a portfolio company owned by Venhill. Howard was effectively on both sides of the Auto-trol transactions because he was CEO and controlled Auto-tel when, as general partner of Venhill, he caused Venhill to make investments in Auto-trol. Although Auto-trol experienced some success following Venhill's acquisition in 1973, the company only survived due to substantial investments by Venhill. By July of 2005, Howard had caused Venhill to make 186 loans to, and invest \$85.4 million in, Auto-trol. As early as 1990, Auto-trol began to exhibit strong signs of failure. Consequently, Howard began to cause Venhill to make loans to Auto-trol at rates and upon terms that would not have been available to Auto-trol in the marketplace. Tatnall and Joe were aware that Howard, in his capacity as general partner of Venhill, was causing Venhill to invest substantial sums of money in Auto-trol and expressed their reservations as early as 1994. In spite of their reservations, Tatnall and Joe continued to allow Howard to invest Venhill funds in Auto-trol. Although Tatnall and Joe, under Venhill's partnership agreement, had the power to remove Howard, they did not do so and instead limited Howard's ability unilaterally to cause the Trusts to loan money to Venhill to fund Auto-trol. Nevertheless, although Howard could no longer cause the Trusts to invest in Auto-trol through Venhill, Howard

used his discretion as general partner of Venhill to fund Auto-trol's operations using Venhill's remaining capital. Additionally, Howard, acting as CEO for Auto-trol on the one hand and general partner of Venhill on the other, caused Venhill to convert much of the Auto-trol debt held by Venhill into equity. In January 2005, Howard, sensing that he would soon be removed as general partner of Venhill, took a number of actions designed to protect Auto-trol from Venhill's control and to benefit himself. Howard transferred the shares of Auto-trol owned by Venhill to a newly created LLC of which Venhill was the sole member but that Howard controlled as manager. Additionally, Howard caused Venhill to (i) loan Auto-trol \$2 million, (ii) pay his personal lawyers, and (iii) reimburse him for the out-of-pocket costs he incurred related to litigation involving the Trusts. Following his removal, Howard continued to support Auto-trol by attempting to force Venhill to subscribe to a stock offering to prevent severe dilution of its equity interest in Auto-trol.

Plaintiffs brought actions against Howard alleging he breached his fiduciary duties of loyalty and care. Plaintiffs sought, *inter alia*, damages for all of the losses suffered by Venhill (including the loss of profits that would have been made if funds were invested consistent with Venhill's other investments), rescission of a promissory note that consolidated all of the debt owed to Venhill into a single note that would not come due until 2020, the cancellation of any security interest in Auto-trol's real property and attorneys fees incurred by plaintiffs in connection with their action.

The court first discussed the standard of review relating to Howard's liability for damages to Venhill and the Trusts. Although the court found that the parties agreed the entire fairness standard should apply to the investments in Auto-trol because of their interested character, they disagreed on how that standard should apply. Howard argued that plaintiffs could not challenge the Auto-trol investments because Joe and Tatnall were aware that he was causing Venhill to invest in Auto-trol and they failed to exercise their rights as limited partners in Venhill to remove him as a general partner. In essence Howard argued that plaintiffs acquiesced and ratified his actions. The court was not persuaded and concluded that an equity holder does not have an affirmative duty to exercise its powers of removal if it disagrees with a fiduciary's actions, and the court concluded that the parties did not acquiesce or ratify any of Howard's actions. To the contrary, the court found that "nothing [plaintiffs] did gave Howard any reason to believe that they approved his desire to continue funding Auto-trol." Similarly, the court rejected defendant's ratification argument because neither Joe nor Tatnall consented to any of the relevant investments.

Additionally, Howard argued that the exculpation provision contained in the Venhill partnership agreement modified the entire fairness standard. Based on the exculpation provision, Howard argued that he would only be liable for damages if it could be shown that he (i) engaged in bad faith acts, (ii) made grossly negligent decisions, or (iii) committed acts of willful and wanton misconduct. On this issue, the court reasoned that the entire fairness standard was at its core an inquiry to determine whether a transaction should be set aside. The court went on to state "[the standard] has only a crude and potentially misleading relationship to the liability any particular fiduciary has for involvement in a self dealing transaction." In this instance, "the exculpation

provision prevents [plaintiffs] from recovering from Howard unless he acted in bad faith, with gross negligence, or engaged in willful and wanton misconduct.” Thus, an interested transaction could be enjoined if it failed the entire fairness test, but if the transaction were consummated, plaintiffs could only recover damages if Howard acted in the proscribed manner. Interestingly, the court noted that under the applicable standard—a common one in alternative entities—an interested transaction could be substantially unfair and yet not give rise to personal liability. Still, to determine whether Howard would be personally liable, the court found it helpful to analyze the Venhill investments in Auto-trol under the entire fairness standard. The first prong of the entire fairness test required that the court consider the process used to implement the transactions. Finding it impossible “to detail all the ways in which the process fell short of fair” the court highlighted the following points: (i) Howard never conducted a market check; (ii) Howard never engaged or sought the advice of competent professionals; and (iii) Howard did not engage in any analytical process. Thus, the court found the process used by Howard to make investments for Venhill in Auto-trol “grossly deficient.” The second prong of the entire fairness test requires a court to review the substantive fairness of a transaction. In this regard, the court found the transaction substantively unfair for the following reasons: (i) the terms and conditions of the investments were not fair to Venhill and Venhill could have obtained better terms and conditions from other borrowers, (ii) Auto-trol did not have a plan to return the company to solvency, (iii) Howard’s implicit admission that he believed Auto-trol equity was worth only \$1 and his unwillingness to pay off any of the substantial debt owed by Auto-trol “demonstrates that [the] transactions were unfair,” and (iv) the imbalance of the Venhill investment portfolio which had over 50% of its assets invested in Auto-trol. Howard argued that the exculpation provision contained in the Venhill partnership agreement protected him from liability because he acted in good faith and subjectively believed that Auto-trol would be a financial success. The court disagreed, however, finding that Howard did not subjectively believe that Auto-trol would be a success as evidenced by his unwillingness to acquire Auto-trol. The court found the case to present a “clear case of fiduciary disloyalty, although Howard’s motives were not financial enrichment they were personal.” In sum, the court found that Howard acted in bad faith and, additionally, that he engaged in willful misconduct and acted in a grossly negligent manner. Thus the court awarded damages to Venhill. In addition, with respect to the debt that was consolidated into a single note in 2003, the court ordered rescission of that note to allow Venhill to collect on debts based on the obligations owed to it by Auto-trol prior to the consolidation. Finally, the court set aside the security interest granted Howard.

With respect to their attorneys fees claim, plaintiffs argued that Howard’s actions were of such an egregious nature that the bad faith exception to the American Rule should apply and Howard should pay their fees. The court reasoned that the bad faith exception to the American Rule could not apply to every case of intentional fiduciary wrongdoing; otherwise the rule would be eviscerated. Instead the bad faith exception to the American Rule should be reserved for “unusually deplorable behavior.” In this case, the court found that the following actions would fall within the bad faith exception: (i) the actions taken by Howard in transferring the equity of Auto-trol to the newly formed LLC, (ii) the coercive stock subscription offering that would have severely diluted Venhill’s equity

holdings in Auto-trol, and (iii) causing Venhill to make payments to his attorneys. As to these actions the court required that Howard pay plaintiffs' related attorneys' fees.

28. *Fisk Ventures, LLC v. Segal*, C.A. No. 3017-CC (Del. Ch. May 7, 2008 and July 3, 2008)

Genitrix, LLC (the "Company") was formed to develop and market biomedical technology. The equity in the Company was divided into three classes, a Class A membership interest primarily owned by Dr. Andrew Segal ("Segal"), a Class B membership interest primarily owned by Dr. H. Fisk Johnson ("Johnson"), Fisk Ventures, LLC ("Fisk") and affiliates of Fisk and Class C membership interests owned by passive investors. The Company's LLC Agreement required the cooperation of the Class A and Class B members for the effective operation of the Company. However, the Class A and Class B members consistently disagreed on matters related to research and financing. The failure of the Class A and Class B members to agree left the Company virtually frozen and at the time of litigation the Company had only one employee, no office, no capital funds, no grant funds and it generated no revenue. The Class B members initiated a suit to dissolve the Company under Sections 18-801 and 18-802 of the LLC Act. In response, Segal counterclaimed against Fisk, Johnson and Stephen Rose and William Freund (who were representatives of Fisk on the board of representatives of the Company) alleging that the counterclaim/third party defendants breached the Company's LLC Agreement, breached the implied covenant of good faith and fair dealing implicit in the LLC Agreement, breached their fiduciary duties to the Company and tortiously interfered with Segal's employment agreement with the Company. Johnson moved to dismiss under Rule 12(b)(2) for lack of personal jurisdiction and the other counterclaim/third party defendants moved to dismiss the claims under Rule 12(b)(6) for failure to state a claim upon which relief could be granted. The court's opinion addressed the motions to dismiss made by the counterclaim/third party defendants.

The court first analyzed Johnson's motion for dismissal under Rule 12(b)(2) and his contention that the court did not have personal jurisdiction over him. The court agreed with Johnson that service of process was not appropriate under 10 *Del. C.* § 3104 and Section 18-109 of the LLC Act. Under Section 3104, Delaware's long arm statute, the court concluded that although Johnson did have limited contacts with Delaware, the claims asserted by Segal did not arise from and had no nexus with those limited contacts and therefore service of process under Section 3104 was improper.

Under Section 18-109 of the LLC Act, service of process is appropriate only as to named managers of an LLC or those who participate materially in the management of an LLC. The statute makes clear that the power to appoint a manager does not constitute participation in the management of the LLC. Segal argued that Johnson participated materially in the management of the Company because (i) he "controlled" the actions of the persons he appointed to the board and (ii) the LLC Agreement provided him with broad management rights. The court rejected the assertion that Johnson controlled his appointees as conclusory and held that the mere fact that Johnson had the right to affect the activities of the Company through his representative did not mean that he participated materially in the management of the Company. Thus, the court granted Johnson's motion to dismiss.

The court granted all the other counterclaim defendants' motion to dismiss under Rule 12(b)(6). As to Segal's first claim for breach of contract with respect to the Company's LLC Agreement, the court noted that before it could begin its analysis as to whether a breach had occurred, it had to determine that there was a duty. In this respect it found that Segal failed to identify any breaches of duties found in the Company's LLC Agreement. Segal argued that the Company's LLC Agreement established a code of conduct to which the members of the Company were bound, namely, a duty to act without gross negligence, fraud or intentional misconduct. The court, however, found that the provisions cited by Segal did not establish a code of conduct, but rather limited or waived liability, and the court declined to turn an exculpation clause into an all encompassing and seemingly boundless standard of conduct. Further, the court reasoned that even assuming such a code of conduct had been created, Segal failed to show that the counterclaim defendants acted with gross negligence, willful misconduct or bad faith or knowingly violated the law. The fact that the Class B members did not take actions suggested by Segal to assist the Company in obtaining financing did not indicate that they acted in bad faith. Additionally, Segal argued that the Class B members breached the Company's LLC Agreement by removing him as CEO with a vote of less than 75% of the board. The court found, however, that under the Company's LLC Agreement and Segal's employment agreement, the board was entitled to remove Segal with a vote of less than 75% of the board, thus Segal's removal by less than 75% of the board was not a breach of duty but rather an exercise of a contractual right.

Segal also alleged that the counterclaim defendants breached the implied covenant of good faith and fair dealing contained in the Company's LLC Agreement by frustrating or blocking the financing opportunities proposed by Segal. The court, in discussing the implied covenant, found that it is invoked to protect the spirit of what was actually bargained and negotiated for in the contract and further, because it is implied, it cannot be invoked where the contract itself expressly covers the subject at issue. Here, the court found that the Company's LLC Agreement did not provide Segal with a unilateral right to determine what fundraising or financing opportunities the Company would pursue. In fact, the Company's LLC Agreement specifically addressed financing and provided that financings required the approval of 75% of the board. The court found that implicit in this provision was the right of Class B board representatives to disapprove of and block Segal's proposals.

Segal also argued that the counterclaim defendants violated their fiduciary duties to Segal. In support of his breach of fiduciary duty claim, he pointed to the same provisions of the Company's LLC Agreement that he cited for his breach of contract claims. The court found that these claims should be dismissed for two reasons. First, the Company's LLC Agreement, as permitted by the LLC Act, had restricted or even eliminated fiduciary duties. Second, even assuming that there remained a fiduciary duty to not act in bad faith or with gross negligence, Segal failed to allege facts sufficient to support a claim that such duty had been breached. The court also dismissed Segal's claim that Rose and Freund tortiously interfered with his employment contract because the court concluded that Segal failed to plead facts indicating that there was ever a breach of his employment contract.

Following the court's decision, Segal filed a motion for reargument pursuant to Rule 59(f). In his motion, Segal sought reargument on two issues: (i) the sufficiency of his claim that Rose and Freund breached their fiduciary duties; and (ii) the claim of tortious interference with Segal's employment contract by Rose and Freund. With respect to Segal's claims that Rose and Freund breached their fiduciary duties, Segal argued that the court's dismissal was based on a misunderstanding of the fiduciary duties owed by Rose and Freund as representatives of the Company. Segal argued that the court based its dismissal on its conclusion that members of the Company owed no duties to each other but Segal argued that the representatives owed duties different than those owed by members of the Company. The court stated that it did not misunderstand the Company's LLC Agreement and in fact, it specifically concluded that "because the agreement does not expressly articulate fiduciary obligations, they are eliminated." Further, the court noted that its previous opinion addressed the potential liability for breaches of fiduciary duties by the representatives throughout the opinion. The court stated, "even if Segal were correct that in the LLC Agreement there remained a fiduciary duty not to act in bad faith or with gross negligence, Segal has manifestly failed to allege facts sufficient to support a claim that anyone had breached such a hypothetical duty." Thus, because the court concluded that Segal had failed to demonstrate that the court's decision was predicated upon a misunderstanding of a material fact or a misapplication of law, his motion for reargument on the fiduciary duty claim was denied. Similarly, the court denied Segal's motion for reargument on the claim of tortious interference finding that, first, its initial holding did not misapply the law and, second, that even if it did, the outcome of the decision would not be affected because the doctrine of tortious interference requires that the defendants be strangers to the contract in question and the defendants were not and further that Segal failed to plead facts showing that the defendants had exceeded the scope of their authority which would be necessary to support his contention that the stranger doctrine did not apply.

29. *Madison Real Estate Immobilien-Anlagegesellschaft Beschränkt Haftende KG v. Kanam USA XIX Ltd. P'ship.*, C.A. No. 2863-VCP (Del. Ch. May 1, 2008)

Plaintiff limited partner, who was in the business of making initial investments in partnerships and then conducting tender offers for additional interests in such partnerships, made a small investment in a Delaware limited partnership and then made several books and records demands on the partnership for detailed information concerning the partnership's principal assets. When the general partner failed to respond, plaintiff brought this action alleging that the general partner, in refusing to make available the requested information, breached plaintiff's rights under Section 17-305 of DRULPA and the partnership agreement.

With respect to plaintiff's statutory claim, the court first analyzed whether plaintiff had a proper purpose for inspecting the information it sought under Section 17-305 of DRULPA. The plaintiff stated two purposes for its demand: (1) to value its existing investment in the partnership; and (2) to value the partnership as a whole in anticipation of making a tender offer. The court stated that a limited partner bears the burden of proving a proper purpose and where a limited partner has more than one purpose, the primary purpose must be proper and any secondary purpose, whether proper or not, is

irrelevant. Thus, in determining whether plaintiff had stated a proper purpose, the court held that a critical issue was whether plaintiff's primary purpose was to value its existing investment in the partnership or to value the partnership as a whole in anticipation of making a tender offer. Based on the evidence, which included an admission by plaintiff that valuing the partnership as a whole in anticipation of making a tender had always been the chief purpose for its inspection demand, the court concluded that plaintiff's primary purpose for inspecting the requested information was to determine whether or not to make a tender offer and if so on what terms. The court stated that plaintiff's status in valuing a tender offer is that of a bidder, not of a limited partner valuing its interest in the partnership. The court concluded that plaintiff's primary purpose for inspecting the requested books and records was not reasonably related to its interest as a limited partner and, therefore, was not a proper purpose under Section 17-305 of DRULPA.

The court also noted that Section 17-305(b) of DRULPA provided the general partner with an alternative and independent basis for denying plaintiff's statutory demand to inspect the requested information because (1) the general partner had demonstrated that it was required by law and certain third party confidentiality agreements to keep certain of the requested information confidential and (2) the general partner had established its reasonable belief that the requested information was in the nature of trade secrets. Accordingly, the court concluded that plaintiff did not have a statutory right to inspect the requested information pursuant to Section 17-305 of DRULPA and consequently that the general partner had not breached DRULPA.

The court next addressed plaintiff's claim for breach of contract. Section 10(a) of the partnership agreement required the partnership to make available for examination by the partners its "books of account." The main contention between the parties was whether the various books and records sought by plaintiff constituted "books of account" under Section 10(a) of the partnership agreement. The court determined that the term "books of account" as used in the partnership agreement had a fairly narrow definition and was less expansive than the term "books and records." Central to the court's determination was a provision in the partnership agreement that provided that the partnership's "books of account" shall be closed as of the end of each fiscal year. The court construed the term "books of account" as used in the partnership agreement to refer to a limited range of financial documents of the partnership, such as its general ledger and the financial statements derived from the general ledger. Accordingly, the court held that the books and records sought by plaintiff fell outside the scope of the books of account referred to in Section 10(a) and, thus, plaintiff was not entitled to inspect the requested information pursuant to the provisions of the partnership agreement. Having concluded that plaintiff was not entitled to the requested information under the partnership agreement, the court held that it was unnecessary to rule on the general partner's "improper purpose defense" to plaintiff's breach of contract claim.

30. *Monier, Inc. v. Boral Lifetile, Inc.*, C.A. No. 3117-VCN (Del. Ch. Feb. 28, 2008)

Plaintiff and defendant were the only members of a Delaware LLC, each owning a fifty percent membership interest. Following a dispute among the members as to the distribution policy of the LLC, plaintiff filed an action for declaratory judgment in the

Court of Chancery seeking a declaration as to the percentage of the LLC's net income that was required under the LLC Agreement to be distributed. This opinion addressed defendant's motion to dismiss.

The LLC was managed by a six-member management committee (the "Management Committee"), of which plaintiff and defendant were each permitted to appoint three members. The LLC Agreement provided that 50% of the net income of the LLC was required to be distributed on or before March 31 of the following calendar year "or at such other times as determined by the Management Committee." The LLC Agreement further provided that the LLC could only make other distributions so long as the LLC distributed 50% of its net income to the members on at least an annual basis "unless the Management Committee approves greater or lesser distributions without dissenting vote." In 2000, the Management Committee unanimously decided that "[f]rom the year 2000, a dividend will be paid annually equal to the audited net profits of the [LLC]." This decision was reflected in the minutes of the LLC which were signed by the Secretary of the LLC. The LLC adhered to this distribution policy over the next five years. In 2005, the members of the Management Committee appointed by defendant questioned the prudence of continuing to adhere to this distribution policy and recommended a return to the 50% distribution rate. The members of the Management Committee appointed by plaintiff disagreed and, without agreement among its members, no formal Management Committee action was adopted regarding the proper distribution rate.

Plaintiff argued that the Management Committee's action in 2000 set the distribution rate at 100% in perpetuity unless and until the Management Committee acted unanimously to change it, or, as an alternative argument, that the Management Committee action had effected an amendment to the distribution policy in the LLC Agreement. The LLC Agreement required amendments to be approved by the Management Committee and signed by all members of the LLC. Plaintiff argued that because the members of the Management Committee unanimously approved the increase of the distribution rate and because, at the time of such approval, the members of the Management Committee constituted majorities of both plaintiff's and defendant's boards of directors, the Management Committee and the members of the LLC, in effect, consented to the amendment in accordance with the provisions of the LLC Agreement. Plaintiff asserted that the requirement to sign the amendment was satisfied by the Secretary's act of signing the minutes.

The court determined that it could not at this stage of the proceedings conclude that plaintiff's interpretation of the distribution provisions of the LLC Agreement was unreasonable. The court found the LLC Agreement to be unclear as to whether the Management Committee's authority to adjust the distribution rate was intended to endure until the Management Committee acted unanimously to change the rate. Defendant argued that such an interpretation of the LLC Agreement would be tantamount to permitting the Management Committee to amend the LLC Agreement contrary to other provisions of the LLC Agreement that provided for an amendment procedure involving all members. The court stated that while defendant's interpretation of the distribution provisions of the LLC Agreement may be the better reading, it could not find at this stage

that it was the only reasonable reading of such provisions and thus could not grant defendant's motion to dismiss.

The court addressed in a footnote plaintiff's argument that the Management Committee action in 2000 had effected an amendment to the LLC Agreement. The court stated that nothing in the Management Committee's action suggested an intent of the Management Committee or the members to amend the LLC Agreement and that the only reasonable inference to be drawn from such action is that the Management Committee was doing nothing more than exercising its authority to set the distribution rate.

Defendant also claimed that if the Management Committee's action in 2000 had changed the distribution rate in perpetuity until the Management Committee unanimously decreed otherwise, it would constitute an abdication of the Management Committee's fiduciary obligations to the LLC and its members. The court rejected this argument, holding that if the members of the LLC intended to confer broad authority on the Management Committee to establish the distribution rate, and the Management Committee validly exercised that authority, there is no basis to claim that the Management Committee breached its fiduciary duty simply by adopting a change to the baseline distribution rate.

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