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Case No. 3148-VCN

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

DALE E. DAWSON and BRUCE H. DeWOOLFSON,	:	
Plaintiffs,	:	
v.	:	**C.A. No. 3148-VCN**
PITTCO CAPITAL PARTNERS, L.P., a Tennessee limited partnership, MORGAN KEEGAN EARLY STAGE FUND, L.P., a Delaware limited partnership, MORGAN KEEGAN EMPLOYEE INVESTMENT FUND, L.P., a Delaware limited partnership, MICHAEL S. STARNES, ANDREW SEAMONS, PHILIP B. VAN WORMER, JOHN H. GRAYSON, JR., ALAN L. GARNER, JACKSON CAPITAL PARTNERS, LIMITED PARTNERSHIP, a Delaware Limited Partnership, LANESCAN, LLC, a Delaware limited liability company, and VEHICLE SAFETY & COMPLIANCE, LLC, a Delaware limited liability company,	:	
Defendants.	:	

MEMORANDUM OPINION

Date Submitted: January 18, 2012
Date Decided: April 30, 2012

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Seth J. Reidenberg, Esquire of The Chartwell Law Offices, LLP, Wilmington, Delaware, and Christopher J. Belter, Esquire of Goldberg Segalla LLP, Buffalo, New York, Attorneys for Defendants.

NOBLE, Vice Chancellor

I. INTRODUCTION

Plaintiff Dale E. Dawson ("Dawson") and Plaintiff Bruce H. DeWoolfson ("DeWoolfson" and, together with Dawson, the "Plaintiffs") invested in a small start-up company, LaneScan, LLC ("LaneScan"). Before long, LaneScan ran into financial difficulties and was on the verge of insolvency. LaneScan was presented with only one feasible option for survival: a merger with Vehicle Safety and Compliance, LLC ("VSAC") (the "Merger") in which the holders of LaneScan's preferred membership interests (the "Preferred Interests") (the "Preferred Members") would be severely diluted and, purportedly, be required to surrender certain LaneScan secured notes that they acquired when they initially invested in LaneScan (the "Notes"). At the time, VSAC was a company that consisted of cash, some intellectual property, and an idea. It had no marketable product. It had only recently been created by merging two other companies, Report on Board, LLC ("ROB") and Vehicle IP, LLC ("VIP"), into two of its subsidiaries. Furthermore, its business plan hinged on the adoption of new federal regulations championed by VSAC.

LaneScan and VSAC shared many of the same investors, directors, and key employees. But, not all of LaneScan's Preferred Members, such as the Plaintiffs, were also investors in VSAC. After the Merger, LaneScan's former Preferred

Members held very small stakes in the combined entity, as a result of an exchange ratio that assigned a value to VSAC about nine times that assigned to LaneScan.

The regulations VSAC was counting on were not adopted, and ROB, VSAC's main operating subsidiary before the Merger, filed for bankruptcy about a year after the Merger was completed. The Plaintiffs complain that the Merger improperly deprived them of their Notes and that a return of capital provision was inappropriately excised from LaneScan's Amended and Restated Limited Liability Company Operating Agreement (the "LLC Agreement")[1] in conjunction with the Merger. For damages, they request, essentially, a return of their original investment in LaneScan (both the Notes and their equity investment) with pre- and post-judgment interest, plus attorneys' fees and expenses. The defendants (all of the defendants, together, collectively, the "Defendants") counter that the Plaintiffs are simply fighting the unfortunate consequences of a failed business undertaking. The Plaintiffs, they contend, invested in a risky venture. When LaneScan was facing its demise, a majority of its board of directors (the "Board")[2] and a majority of the Preferred Members made the only rational decision and agreed to the Merger. The actions decried by the Plaintiffs were appropriate and permitted by the LLC

[1] Joint Exhibit ("JX") 13 ("LLC Agreement").
[2] Although organized as a limited liability company (an "LLC"), LaneScan called its governing body a board of directors. *See* LLC Agreement at § 4.1.

Agreement, according to the Defendants. As is often the case, the truth of the matter lies somewhere in the middle.

II. THE PARTIES

The Plaintiffs were investors in LaneScan. Dawson owned $220,734 of Notes and a 7.556% equity interest in LaneScan through ownership of Preferred Interests.[3] His Preferred Interests represented 7.96% of the total Preferred Interests.[4] DeWoolfson owned $55,184 of Notes and a 1.889% equity interest in LaneScan through ownership of Preferred Interests. His Preferred Interests represented 1.99% of the total Preferred Interests.

Defendant Pittco Capital Partners, L.P. ("Pittco"), a Tennessee limited partnership, owned $551,835 of Notes and an 18.891% equity interest in LaneScan through ownership of Preferred Interests. Its Preferred Interests represented 21.2% of the total Preferred Interests. It also owned a 35.2% equity interest in ROB through ownership of ROB preferred interests and was a significant investor in VIP. After ROB and VIP merged into subsidiaries of VSAC, Pittco held a 38.21% equity interest in VSAC through ownership of VSAC preferred interests.

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[3] The value of the Notes and the percentages of equity ownership are drawn from Exhibit B of the Agreement and Plan of Merger for the Merger (the "Merger Agreement") and are the values as of the time of the Merger. JX 107 ("Merger Agreement"). The value of the Notes includes the amount of accrued interest at the time of the Merger. *See id.* The percentage of the total Preferred Interests owned by each Preferred Member is drawn from the Pre-Trial Stipulation and Order ("Pre-Trial Stipulation") and are the values as of the time of the Merger.

[4] In addition to the parties' percentage of ownership of LaneScan's total equity, their percentage of ownership of total Preferred Interest is relevant because of certain voting rights granted only to Preferred Members. *See infra* Part III.B.4.

Defendant Andrew Seamons ("Seamons"), a Managing Partner of Pittco and Pittco's designee to the Board, was the chairman of the Board. Seamons also served as chairman of ROB's and VSAC's boards.

Defendant Michael S. Starnes ("Starnes") owned $413,877 of Notes and a 14.168% equity interest in LaneScan through ownership of Preferred Interests. His Preferred Interests represented 15.8% of the total Preferred Interests. Starnes served as his own director-designee to the Board. He also owned a 35.2% equity interest in ROB through ownership of ROB preferred interests and was a significant investor in VIP. After ROB and VIP merged into subsidiaries of VSAC, Starnes held a 38.21% equity interest in VSAC through ownership of VSAC preferred interests. Starnes served on ROB's Board of Governors and designated a director to VSAC's board of directors.

Defendant Morgan Keegan Early Stage Fund, L.P. ("MKESF"), a Delaware limited partnership, owned $214,405 of Notes and a 7.364% equity interest in LaneScan through ownership of Preferred Interests. Its Preferred Interests represented 8.2% of the total Preferred Interests.

Defendant Morgan Keegan Employee Investment Fund, L.P. ("MKEIF"), a Delaware limited partnership, owned $59,595 of Notes and a 2.047% equity interest in LaneScan through ownership of Preferred Interests. Its Preferred Interests represented 2.3% of the total Preferred Interests.

Defendant John H. Grayson, Jr., ("Grayson") was the director-designee of Morgan Keegan & Company ("Morgan Keegan"), which controlled MKESF and MKEIF. He was also an Executive Managing Director and Director, Investment Banking, of Morgan Keegan.

Defendant Philip Van Wormer ("Van Wormer") was a member of the Board and Chief Executive Officer ("CEO") of LaneScan. Van Wormer owned $17,655 of Notes, a 0.916% equity interest in LaneScan through ownership of Preferred Interests, and a 4.000% equity interest in LaneScan through ownership of LaneScan common interests (the "Common Interests").[5] His Preferred Interests represented a small fraction of the total Preferred Interests. Together, Van Wormer, Starnes, Seamons, and Grayson constituted four of the five directors of the Board, and are referred to, collectively, as the "Director Defendants." Van Wormer also

[5] LaneScan had two forms of equity interests: Preferred Interests and Common Interests. The existence of a small number of Common Interests is the reason for the slight variance between the Preferred Members' percentage of ownership of LaneScan's total equity and their percentage of ownership of total Preferred Interests. Together, the Preferred Interests and Common Interests will be referred to as "Membership Interests." Holders of the Common Interests will be referred to as "Common Members." Together, the Preferred Members and Common Members will be referred to as "Members." "Members" is a defined term in the LLC Agreement, and certain portions of the LLC Agreement utilizing that term are quoted and referred to throughout this Memorandum Opinion. Although the term "Member," as it is defined in the LLC Agreement, is technically broader than the definition given above, this technical distinction is irrelevant under the operative facts. Pursuant to § 1.1 of the LLC Agreement, the "Members" constitute the "members" of LaneScan, as that term is defined in 6 *Del C.* § 18-101(11). According to § 1.1 of the LLC Agreement, "Members" was defined as the persons set forth on Schedule A (the owners of Common Units and Preferred Units), "Additional Members," and others later admitted as Members. Additional Members were, essentially, owners of other equity securities or equity equivalents. Since the Preferred Interests and Common Interests were the only equity securities issued, the actual "Members," as that term is defined in the LLC Agreement, were the Preferred Members and Common Members.

owned a small number of common interests of ROB, which were converted into a small number of common interests in VSAC when ROB merged into a subsidiary of VSAC.

Defendant Alan L. Garner ("Garner") owned $82,775 of Notes and a 2.834% equity interest in LaneScan through ownership of Preferred Interests. His Preferred Interests represented 3.2% of the total Preferred Interests.

Defendant Jackson Capital Partners, L.P. ("Jackson Capital"), a Delaware limited partnership, owned $193,142 of Notes and a 6.612% equity interest in LaneScan through ownership of Preferred Interests. Its Preferred Interests represented 7.4% of the total Preferred Interests. Jackson Capital Management, LLC, a Delaware LLC owned and controlled by Garner, is the sole general partner of Jackson Capital. Jackson Capital, Pittco, MKESF, MKEIF, Starnes, and Garner each owned Preferred Interests and, collectively, will be referred to as the "Investor Defendants."

VSAC was a Delaware LLC. One of its subsidiaries merged into LaneScan in the Merger.

LaneScan was a Delaware LLC. It merged with a subsidiary of VSAC in the Merger.

III. BACKGROUND

A. *The Formation and Funding of LaneScan*

LaneScan was formed on February 6, 2004, as Lane Acquisition, LLC, a Delaware LLC.[6] Its purpose was to acquire and license assets from two privately-held companies, ARCM Corporation and CEVAL, Inc., to market intelligent-mirroring and collision-avoidance devices for commercial trucks.[7] LaneScan had two products. The first product utilized a control box placed inside the truck's cab. At the touch of a button, the mirror would move to scan the driver's blind spots and then automatically return to its original setpoint when the button was released. The second product used a sensor automatically to move the rearview mirror in proportion to the changing angle of the trailer relative to the tractor; this offered early jackknife warning protection.[8] The patents related to this technology were especially important to the potential success of this business.[9] Bradley Larschan ("Larschan") and his friend[10] Van Wormer developed LaneScan's business plan and recruited investors.[11] At its inception, LaneScan's

[6] Pre-Trial Stipulation ¶ 5.
[7] Trial Tr. ("Tr.") 309-14.
[8] PPM at DDOO149.
[9] *Id.* at 312, 318-19.
[10] *Id.* at 376.
[11] *Id.* at 309-14.

sole member was Pittco[12] and its sole director was Seamons, the Managing Director of Pittco and a friend of Larschan.[13]

In November of 2004, LaneScan distributed a private placement memorandum (the "PPM")[14] to potential investors, including the Plaintiffs.[15] LaneScan sought to raise between $4.9 million and $6 million thought the issuance of "Units" priced at $100,000 per Unit.[16] According to the PPM, each Unit would "consist of [a] [P]referred [I]nterest in the Company . . . and a [Note] . . . in the amount of $50,000."[17] The Plaintiffs had been investors in ARCM, and they obtained their Units by rolling over their investment in ARCM into LaneScan.[18] Dawson rolled over $400,000 of his ARCM investment and received four Units, and DeWoolfson rolled over $100,000 of his ARCM investment and received one Unit.[19] On December 22, 2004, LaneScan issued Dawson a Note in the amount of $200,000 and issued DeWoolfson a Note in the amount of $50,000;[20] the security agreement related to the Notes (the "Security Agreement") was entered into on the same day.[21] The Preferred Interests were issued pursuant to the LLC Agreement.

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[12] JX 7 at PIT001910.
[13] Tr. 376.
[14] JX 9 ("PPM").
[15] Pre-Trial Stipulation ¶ 6.
[16] *Id.* at ¶ 7.
[17] PPM at 1.
[18] Tr. 28-30, 81.
[19] *Id.*
[20] JX 144 (Dawson's Note); JX 145 (DeWoolfson's Note).
[21] JX 14 ("Security Agreement").

Dawson executed the LLC Agreement on December 17, 2004, and DeWoolfson executed the LLC Agreement on December 19, 2004.[22] The Court finds that the capital contributions associated with Dawson's and DeWoolfson's Preferred Interests were $200,000 and $50,000, respectively.[23]

Many of the Defendants also owned equity interests in LaneScan and Notes. The following Defendants purchased Units in the December 2004 round of financing and, immediately thereafter, owned the following Preferred Interests[24] and Notes[25]: (1) Pittco: $500,000 capital contribution, Preferred Interests equal to

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[22] LLC Agreement at LV 000058, LV 000061.

[23] LLC Agreement at Schedule A. The Plaintiffs and the Defendants disagreed regarding the value of the capital contribution associated with the Plaintiffs' Preferred Interests. The Plaintiffs argued that their capital contributions were twice what the Court found above, or $400,000 for Dawson and $100,000 for DeWoolfson. Plaintiffs' Opening Post-Trial Br. ("Opening Br.") 43. These values represent the entire amount invested by each Plaintiff. In support of their argument, the Plaintiffs rely upon an email sent to Dawson by Larschan, a balance sheet showing an amount for capital contributions, and their own personal understanding of the value of their capital contributions. *Id.* (citing JX 10; Dawson Dep. 35-37; DeWoolfson Dep. 28-29). The Defendants contend that the Plaintiffs' capital contributions were in the amounts found by the Court. The Court concludes that Exhibit A of the LLC Agreement sets forth the amount of the members' capital contributions pursuant to § 3.1(a) of the LLC Agreement. According to Schedule A of the LLC Agreement, the Plaintiffs' capital contributions were in the amounts found by the Court above. Furthermore, the Plaintiffs' interpretation, while perhaps not legally impermissible, is certainly unusual and would require a stronger factual basis to support it. Under the Plaintiffs' interpretation, if things went well and LaneScan prospered, they would eventually receive payments in the amount of 150% of their initial investment, in addition to whatever gains they realized from dividends and interest, and a possible premium on the sale of their Preferred Interests. At the same time, 50% of their investment had some downside protection in the form of the security interest in LaneScan's assets that supported the Notes.

[24] Capital contribution values and equity interest percentages are drawn from Exhibit A of the LLC Agreement.

[25] The values of the Notes are drawn from either the Subscription Agreement and Power of Attorney executed by each investor when the investor purchased Units (the "Subscription Agreement") or the individual Notes executed by the named Defendants. *See* JX 170; JX 172; JX 173; JX 174; JX 176; JX 177; JX 178; JX 179; JX 180; JX 184.

19.89% of total equity, and $500,000 in Notes; (2) Garner and Jackson Capital, collectively: $250,000 capital contribution, Preferred Interests equal to 9.94% of total equity, and $250,000 in Notes; (3) Starnes $375,000 capital contribution, Preferred Interests equal to 14.92% of total equity, and $375,000 in Notes; (4) MKESF and MKEIF, collectively: $250,000 capital contribution, Preferred Interests equal to 9.94% of total equity, and $250,000 in Notes; Van Wormer[26]: $25,000 capital contribution, Preferred Interests equal to 0.99% of total equity, and $25,000 in Notes.

Non-party Detwiler Capital Partners, L.P. ("Detwiler Capital"), the majority owner of which was J. Brinton Detwiler ("Detwiler"),[27] was a significant investor in LaneScan. It purchased 10 Units, representing a $500,000 capital contribution, Preferred Interests equal to 19.89% of total equity, and $500,000 in Notes.[28] Like the Plaintiffs, Detwiler opposed the Merger. He brought a lawsuit in this Court related to the Merger[29] that was, ultimately, settled.[30]

Non-party Larschan worked as a consultant for LaneScan and received Common Interests equal to 3.0% of its total equity.[31] In addition to the Common

[26] Van Wormer also received Common Units equal to 4.0% of LaneScan's total equity. Merger Agreement at LV000644.
[27] Pre-Trial Stipulation ¶ 49.
[28] JX 171.
[29] JX 115; JX 198.
[30] Detwiler Dep. 137.
[31] LLC Agreement at Schedule A.

Interests,[32] Larschan and his wife Wojack, who worked part-time as LaneScan's chief financial officer ("CFO"), were also paid significant wages for their services.[33] The remaining equity interests and Notes were held in small amounts by various non-party investors.

B. *The Units' Deal Documents*

1. The PPM

The Units were marketed using the PPM, which provided a description of the Units, LaneScan's business plan, risk factors to consider, and suitability requirements for potential investors.[34] A copy of the LLC Agreement[35] and a form Note[36] were attached to the PPM. Under the heading "SECURITIES BEING OFFERED," the PPM described the Units as "consist[ing] of [a] preferred interest in the company . . . and a secured promissory note of the Company . . . in the amount of $50,000."[37]

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[32] Larschan and Wojack were paid and received their equity interest in LaneScan through their wholly-owned company, the Salisbury Group. Larschan Dep. 49-50.
[33] Tr. 297-98; JX-19 at LS21, LS32, LS27. Larschan's compensation from LaneScan decreased over time as he became more involved in working with ROB. *See* Larschan Dep. 53-54.
[34] *See* PPM.
[35] *Id.* at Exhibit B.
[36] *Id.* at Exhibit C.
[37] *Id.* at 1.

2. The Subscription Agreement

Investors subscribed for Units pursuant to the Subscription Agreement in which they indicated how many Units they were purchasing.[38] Again, the Units were described as "consist[ing] of [a] preferred interest [in] the Company . . . and a secured note of the Company . . . in the amount of $50,000 per Unit."[39] Under the Subscription Agreement, each investor agreed to be "bound by all the terms and provisions of the [LLC] Agreement and to perform all obligations and duties therein imposed upon [the] Member with respect to the Preferred Interests subscribed for hereby[.]" The Subscription Agreement also stated that the investors' "ability to transfer the Preferred Interests and the Note[s] is also severely restricted by the [LLC] Agreement."[40] The Subscription Agreement contained a choice of law provision under which it was to be construed in accordance with the laws of Tennessee.[41] Section 15 of the Subscription Agreement was an integration clause that stated: "This Subscription Agreement constitutes the entire agreement between the parties hereto with respect to the subject matter hereof and may be amended only by a writing executed by all parties."

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[38] JX 12 ("Subscription Agreement").
[39] *Id.* at 1.
[40] *Id.*
[41] *Id.* at ¶ 15. The holders of the Notes will be referred to as "Note holders."

3. The Notes and the Security Agreement

For each Unit purchased, an investor received a $50,000 Note that provided for "interest in arrears on the unpaid principal balance at a fixed annual rate [of] eight percent."[42] Under § 1.1 of the Notes, the principal, together with unpaid interest, was due and payable on December 22, 2014. Pursuant to § 3.4, the Notes were to be construed in accordance with the laws of Tennessee.

Section 2.1 of the Notes listed numerous events of default, including "[i]f, pursuant to or within the meaning of the United States bankruptcy code or any other federal or state law relating to insolvency or relief or debtors . . . [LaneScan] shall . . . (v) admit in writing its inability to pay its debts as they become due."[43] Section 2.3 further provided that "[u]pon the occurrence of an Event of Default hereunder (unless all Events of Default have been cured or waived by the Payee), Payee may, at its option, (i) by written notice to [LaneScan], declare the entire unpaid principal balance of this Note, together with all accrued interest thereon, immediately due and payable." If an event of default occurred, LaneScan was obligated "to pay all reasonable costs and expenses incurred by or on behalf of Payee in connection with Payee's exercise of any or all of its rights and remedies under [the] Note, including, without limitation, reasonable attorney's fees."[44]

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[42] *See, e.g.*, JX 144 (Dawson Note) ("Notes") 1.
[43] *Id.* at § 2.1(c).
[44] *Id.* at § 2.3.

Section 3.1 of the Notes provided that "[n]o waiver by Payee of any right or remedy under [the] Note shall be effective unless in a writing signed by the Payee," and that delay in exercising any right did not act as a waiver of the right. Among other terms protecting the Note holders' rights by limiting or restricting waiver of those rights, § 3.1 states that "no waiver that may be given by Payee will be applicable except in the specific instance for which it is given."

The Notes were secured by certain assets of LaneScan, as documented in the Security Agreement (the "Security Agreement").[45] The Security Agreement, also, was to be construed in accordance with the laws of Tennessee.[46] Among the events of default under the Security Agreement was "[a]ny default in the full and prompt payment when due of all or any part of any indebtedness constituting part of the Obligations hereunder [including the Notes]."[47] If an event of default occurred, the Note holders were entitled to "repayment of the reasonable costs and expenses, including reasonable attorney's fees and legal expenses," incurred by the Note holders in connection with administering the Security Agreement and enforcing their rights granted by it.[48]

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[45] Notes at § 3.8. *See also* Security Agreement.
[46] Security Agreement at § 13(f).
[47] *Id.* at § 7(a).
[48] *Id.* at § 8(b)(i). Section 10(b) also provided for payment of the Note holders' legal fees under similar circumstances.

Section 9 of the Security Agreement stated that "[i]n any instance hereunder where [the Note holder's] approval or consent is required or the exercise of the [Note holder's] judgment is required, the granting or denial of such approval or consent and the exercise of such judgment shall be within the sole discretion of [the Note holder], and [the Note holder] shall not, for any reason or to any extent, be required to grant such approval or consent or exercise such judgment." Section 13(a) protected the Note holders' rights under the Security Agreement by providing that "[n]o amendment of any provision of [the Security] Agreement shall be effective unless it is in writing and signed by [LaneScan] and [the Note holder], and no waiver of any provision of [the Security] Agreement, and no consent to any departure by [LaneScan] therefrom, shall be effective unless it is in writing and signed by [the Note holder], and then such waiver or consent shall be effective only in the specific instance and for the specific purpose for which given." Additionally, § 13(b) provided that delaying exercising a right or partially exercising a right, under the Security Agreement, would not act as a waiver of that right.

4. The LLC Agreement

The Preferred Interests, which constituted part of the Units, were issued pursuant to the LLC Agreement. Also, by executing the Subscription Agreement, an investor agreed "to be bound by all the terms and provisions of the [LLC]

Agreement and to perform all obligations and duties therein imposed upon Member with respect to the Preferred Interests subscribed for [in the Subscription Agreement]."[49] The LLC Agreement also set forth LaneScan's system of internal governance and contained many provisions central to the claims and defenses asserted in this action.

LaneScan was formed in Delaware[50] and the laws of Delaware governed the LLC Agreement.[51] The LLC Agreement created two types of membership interests: Preferred Interests and Common Interests.[52] Preferred Interests were received by investors who purchased Units,[53] and Common Interests were awarded to employees and consultants.[54] Together, the Preferred Interests and Common Interests comprised LaneScan's equity. Schedule A of the LLC Agreement set forth each member's total equity ownership, types of Interests owned, and total capital contributions.[55] The Common Members were not entitled to vote, except as

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[49] Subscription Agreement at § 1. Neither the Notes nor the Security Agreement referred to the LLC Agreement.
[50] LLC Agreement at § 2.1.
[51] *Id.* at § 12.6.
[52] *See id.* at art. III.
[53] *See* Subscription Agreement.
[54] *See* LLC Agreement at § 3.4(b). In total, 28.5% of LaneScan's total equity was reserved for Common Interests, although only a portion of that was issued. *Id.* at § 3.4(b).
[55] *Id.* at § 3.1, Schedule A. Although the capital contribution column on Schedule A is labeled "Initial Capital Contribution," § 3.1 stated that Schedule A was to be amended to reflect changes in a member's "Capital Contribution," and the term "Capital Contribution" was not limited to merely the initial capital contribution. *See* LLC Agreement at § 1.1 (definition of "Capital Contribution"); *id.* at art. V (portion of the LLC Agreement addressing capital accounts).

required by law.[56] The Preferred Members were entitled to vote on "Significant Transactions,"[57] which included, among other possible events: (1) any amendment or repeal of any provision of LaneScan's certificate of formation or the LLC Agreement; and (2) any merger.[58] LaneScan could not enter into a Significant Transaction unless Preferred Members holding at least a majority of the Preferred Interests voted in favor of it; such a vote could be conducted at a meeting or by written consent.[59] Generally, any action that could be taken by the Preferred Members or Common Members could be taken using written consent.[60]

Section 3.1(d) protects member from forced capital contributions:

> No Member, in his, her or its capacity as such, shall be required to lend any funds to [LaneScan] or to make any contribution of capital to [LaneScan], except as otherwise expressly required by [the Delaware Limited Liability Company Act (6 *Del C.* § 18-101, et seq.) (the "Delaware LLC Act")] or [the LLC] Agreement. Neither any loan made nor any service performed by any Member to or for the benefit of [LaneScan] shall be deemed to constitute a contribution to the capital of [LaneScan] for any purpose hereunder.

Furthermore, § 3.1(e) states that "[e]ach Member shall be liable only to make Capital Contributions to [LaneScan] as and when required by [the LLC] Agreement and the other payments required to be made by such Member under the Act or [the LLC] Agreement."

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[56] *Id.* at § 3.1(b).
[57] *Id.*
[58] *Id.* at § 1.1 (definition of "Significant Transaction").
[59] *Id.* at § 3.1(c).
[60] *Id.* at § 3.7(g).

A provision of particular importance to this action is § 10.6. As discussed in detail later in this Memorandum Opinion, § 10.6 was an imprecisely defined drag-along provision that purported to limit the discretion of Members with regard to certain actions requested in connection with a "Company Sale"[61] approved by "a majority of the holders of Preferred Interest[s]" (the "Drag-Along Provision"). Additionally, § 10.13 (the "Return of Capital Provision"), another provision discussed in detail later in this Memorandum Opinion, was a return of capital provision triggered by a Company Sale.

The Board was given broad power to manage LaneScan under article IV of the LLC Agreement. Under § 4.2, there were five members of the Board. One director was to be the CEO, and the following parties each had the right to nominate one director: (1) Pittco; (2) Starnes; (3) Morgan Keegan; and (4) Detwiler Capital. As CEO, Van Wormer served on the Board; Seamons served as the nominee of Pittco; Starnes served as his own nominee; Grayson served as the nominee of Morgan Keegan; and Detwiler served as the nominee of Detwiler Capital.[62] The Board could take any permitted action using written consent.[63] As

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[61] As defined in § 1.1, a "Company Sale" included the sale of 50% or more of the combined Preferred Interests and Common Interests or a sale of all or substantially all of LaneScan's assets.
[62] Pre-Trial Stipulation ¶ 50. Starnes suffered a stroke in January 2006, and, immediately after and subsequent to Starnes's stroke, he acted through Lee L. Piovarcy, Esquire ("Piovarcy") pursuant to a power of attorney. *Id.*
[63] LLC Agreement at § 4.5.

discussed later in this Memorandum Opinion, the duties of officers to LaneScan were set forth in § 4.6(c), and § 7.1 eliminated the duties of Members and directors.

Finally, there are two noteworthy general provisions. The LLC Agreement includes an integration clause at § 12.2.[64] Also, § 12.4 speaks to the Board's ability to amend or modify the LLC Agreement and states, in part:

> Except as otherwise provided in [the LLC] Agreement, [the LLC] Agreement and any provisions hereof may be amended and modified from time to time only by a written instrument adopted by a majority of the [Board.]
>
> Notwithstanding the preceding, the [Board] may from time to time amend and modify the provisions of [the LLC] Agreement . . . in connection with a Drag-Along Sale.

D. *The Creation of ROB, VIP, and VSAC*

The focal point of this action is the Merger between LaneScan and VSAC. As explained below, VSAC itself was the product of a merger between two of its subsidiaries and ROB and VIP, two closely related companies owned and operated by the same group of individuals and entities, many of whom were also involved with LaneScan.

1. <u>ROB</u>

The idea behind ROB had its genesis in a company called Mile Marker that Larschan and Van Wormer had been involved with a couple of years before the

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[64] Section 12.2 stated: "This Agreement, together with all Schedules and Exhibits hereto, constitutes the entire agreement of the Members relating to the Company with respect to the subject matter hereof and supersedes any and all prior contracts or agreements with respect to the subject matter hereof, whether written or oral."

founding of ROB and LaneScan.[65] The product ROB sought to develop was a device that would automatically record data truckers needed for fuel tax and hours-of-service reporting requirements.[66] Larschan believed that the federal Department of Transportation would soon require that this information be electronically recorded, since it was suspected that the system of paper reporting enabled cheating.[67] The primary obstacle to the adoption of such a rule, as perceived by Larschan, was the high price of such devices available at that time, which could cost more than $2,000 apiece.[68] Larschan understood this technology from his experience with Mile Marker, and he believed that by utilizing rapidly advancing cellular phone technology the cost of these devices could be dramatically reduced.[69] Therefore, in 2005 and 2006, Larschan and others thought that ROB could possibly become the low-cost producer of a product that a large number of potential customers would soon be required by law to use. Assuming that scenario developed, ROB appeared to have a promising business plan.

Ultimately, ROB never produced a finished product, never sold any products, and never achieved any sales revenues, although it did obtain five patents.[70] The

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[65] *See* Van Wormer Dep. 34-35.
[66] Tr. 384.
[67] *Id.* at 322-23.
[68] *Id.* at 323-24.
[69] *Id.* at 324-25.
[70] Larschan Dep. 90-91 (never produced a finished product, but received five patents); Tr. 346 (never produced a finished product, never sold a product in the market, and never achieved any sales revenue).

regulations upon which ROB's business plan hinged were not adopted until January of 2011.[71] According to Larschan, in early 2007 it became clear that the mandate would not be adopted.[72] ROB, by then a subsidiary of VSAC, filed for bankruptcy in 2007,[73] and its patents were sold by the bankruptcy trustee to an unrelated company.[74]

In late 2004 or early 2005, around the time LaneScan received funding through the private placement, Larschan created the concept for ROB.[75] During the first half of 2005, while he was also working as a consultant for LaneScan, Larschan devoted a significant amount of time investigating and developing this new venture.[76] ROB was formed in July 2005 as a Tennessee LLC; its LLC operating agreement was substantially similar to that of LaneScan.[77]

There was significant overlap between the key players involved with ROB and LaneScan. The largest investors in ROB were Pittco and Starnes, each of whom made an initial capital contribution of $300,000 and owned 35.2% of ROB's

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[71] Tr. 343-44; Larschan Dep. 95.
[72] *See* Tr. 343-44, 346.
[73] *Id.* at 346.
[74] Larschan Dep. 96.
[75] *Id.* at 62-63.
[76] *Id.* at 185.
[77] *See* JX 23 ("ROB LLC Agreement"). ROB also utilized a Subscription Agreement and Power of Attorney that was substantially similar to that of LaneScan, although ROB did not issue notes with its preferred interests. *See* JX 22 (ROB Subscription Agreement and Power of Attorney).

equity in preferred interests.[78] Van Wormer received a 5% equity interest in ROB through common interests ("ROB Common Interests"), and Larschan and Wojack, together, received a 7.5% equity interest in ROB through ROB Common Interests held by their RoseHart, LLC company.[79] A total of 21% of ROB's equity (in ROB Common Interests) was reserved for Larschan, Wojack, and Van Wormer, to be issued upon the achievement of certain performance goals.[80] No capital contributions were made to ROB by Van Wormer, Larschan, or Wojack.[81] Detwiler was invited to invest in ROB, but he declined to do so.[82] At all relevant times, Larschan was ROB's Chief Manager; ROB's Governors were Larschan, Seamons, and Starnes; and Seamons was ROB's chairman.[83] Wojack was ROB's CFO,[84] the same position she held at LaneScan. Together, through 2005, Larschan and Wojack received a salary of $30,000 per month from ROB, which was paid to their Salisbury Group company.[85]

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[78] ROB LLC Agreement at Schedule A. Starnes invested in ROB through MSMM Realty Investment Company. *See id.*
[79] *Id. See also* Tr. 295-96 (explaining that Larschan and Wojack held their ROB Common Interests in RoseHart, LLC). Larschan and Wojack received their ROB Common Interests in exchange for work they performed promoting the company. Tr. 377.
[80] ROB LLC Agreement at § 3.4(b). This total included the ROB Common Interests issued to Larschan, Wojack, and Van Wormer at ROB's inception. *See* JX 118 at DIGA08530.
[81] ROB LLC Agreement at Schedule A.
[82] Detwiler Dep. 36-37.
[83] Pre-Trial Stipulation ¶¶ 67-69.
[84] Tr. 291-92.
[85] JX 118 at DIGA08531; Larschan Dep. 207.

2. VIP

VIP was created as a Tennessee LLC on December 22, 2005, and, like ROB, its LLC operating agreement was substantially similar to that of LaneScan.[86] Initially, Pittco and Starnes were the only investors in VIP.[87] Pittco and Starnes each invested $305,000 in VIP and received preferred interests in return.[88] Later, all of the other investors in ROB were invited to invest in VIP, and all of them, except for one small ROB investor, did invest in it.[89]

As explained above, the product ROB planned to produce would have recorded data needed for both fuel tax and hours-of-service reporting. The patents that ROB applied for were related to hours-of-service reporting, an area in which there were few pre-existing patents at the time.[90] When Larschan had attorneys perform research to see if there were existing patents applicable to the field of electronic data recording for fuel tax reporting, they discovered that a number of related patents were owned by a company called Remote Dynamics.[91] Larschan was advised that ROB should acquire these patents.[92] VIP was formed to acquire

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[86] *See* JX 31 (VIP LLC Operating Agreement).
[87] *Id.* at Schedule A. Starnes invested in VIP through his company Rivertide Partners, LLC. *See id.*
[88] *Id.*
[89] Larschan Dep. 94-95.
[90] Tr. 328-32.
[91] *Id.* at 331-32.
[92] *Id.* at 332.

them, and the patents were purchased in December of 2005.[93] Although ROB was a failure, VIP continues to operate because its patent portfolio had broader applications.[94]

3. VSAC

Within a month of VIP's formation, Seamons began proposing a plan whereby ROB, VIP, and LaneScan would be owned by a single parent entity.[95] On January 18, 2006, he sent an email to Larschan and Wojack that described a potential two-step combination of the three companies.[96] In step one, ROB and VIP would be acquired by the yet-unformed VSAC, and, in step two, LaneScan would merge with VSAC.[97] This analysis included projected ownership percentages that could be changed based upon the valuation assigned to each business.[98] According to Detwiler, by early February 2006 Seamons, Larschan, and Van Wormer began to act as if ROB and LaneScan were already part of a single enterprise, and he was concerned that they were using LaneScan's resources to further ROB's interests.[99]

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[93] *Id.* at 333.

[94] *Id.* at 344-45. VIP's patent portfolio was divided into three parts. *Id.* at 345. Two of these parts were contributed to two different joint ventures, and the remaining part consists of patents that VIP has attempted to license and concerning which VIP has brought legal actions. *Id.* at 345.

[95] *See* JX 36.

[96] *Id.*

[97] *Id.*

[98] *Id.*

[99] Detwiler Dep. 32-34, 40.

VSAC was formed as a Delaware LLC on February 7, 2006.[100] The directors of VSAC were Larschan, Seamons, and Starnes's designee, Piovarcy; Seamons was the chairman.[101] The ROB and VIP interest holders contributed all of their equity interests in ROB and VIP to VSAC in exchange for equity interests in VSAC, and, as a result, ROB and VIP became subsidiaries of VSAC.[102] Pittco and Starnes (through MSMM Realty Investment Company and Rivertide Partners, LLC) were VSAC's largest equity owners, and, together, they owned 76.41% of VSAC's total equity.[103] Larschan and Wojack (through RoseHart, LLC) and Van Wormer also owned equity interests in VSAC.[104] Larschan was CEO of VSAC.[105]

E. *LaneScan's Poor Performance*

Almost from the start LaneScan did not meet its sales projections. As of June 30, 2005, LaneScan's sales were only 67% of its projected sales, and this measure deteriorated to 36% of expected sales by September 30, 2005.[106] Throughout the first three quarters of 2005, LaneScan spent, on average, more than $100,000 in cash per month than it brought in.[107] In addition to the normal cash disbursements such as payment of payroll and marketing expenses, LaneScan's

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[100] JX 57.
[101] *Id.* at PIT001172.
[102] JX 61.
[103] JX 57 at PIT001211.
[104] *Id.*
[105] Tr. 339.
[106] JX 29.
[107] JX 153 at PIT 000055.

poor sales meant that even more cash was tied up in inventory. Because customers wanted to receive products soon after placing an order, LaneScan had to carry inventory to cover projected sales for the next few months.[108] Thus, when sales did not meet those projections, cash remained tied up in LaneScan's inventory.

As time went on, it became clear that many prospective customers were not going to place orders. A number of issues stymied sales. State budget cuts led to lost sales to state departments of transportation in 2005 and early 2006.[109] In late December 2005, LaneScan learned that a $1.5 million exclusive licensing agreement that Van Wormer had been negotiating would not move forward.[110] Some potential customers had concerns regarding the functionality of the product. Some of these concerns arose when technical difficulties occurred during demonstrations.[111] Other design issues also dampened demand. LaneScan used an older style of mirror that was being rapidly replaced by a newer model.[112] To use LaneScan's mirror on a truck built for the new style of mirror, a customer had to purchase a special bracket.[113] At one point, the manufacturer of this bracket stopped making it.[114] Customers also did not like adding another box inside of

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[108] Tr. 265-66.
[109] *See id.* at 196-97, 202.
[110] *Id.* at 205-06.
[111] *Id.* at 198.
[112] *Id.* at 198-99.
[113] *Id.* at 199.
[114] *Id.*

their trucks and wanted LaneScan to find a way to hide the box behind the dash.[115] The cost of the mirror system was also a concern; retrofitting two mirrors could cost up to $1,500.[116]

With sales consistently falling below expectations and cost-cutting measures insufficient to allow for positive cash flow,[117] it was clear that LaneScan would need to raise more capital in order to survive. Van Wormer, with the help of various directors, tried many approaches to find new investors, but all of them failed. Seamons worked with Van Wormer to create a pitch for venture capital investors, and Seamons and other directors and investors introduced management to different venture capital groups and placement agents.[118] But, LaneScan was too small and falling too short of its revenue goals to attract venture capital financing.[119] Van Wormer investigated the possibilities of obtaining governmental grants related to highway safety or securing bridge financing, but neither of these options was feasible.[120] Institutional investors were not interested either. Van Wormer had contacts with many institutional investors from a previous business venture, and he spoke with "at least a dozen or more different institutional

[115] *Id.* at 199-200.
[116] *Id.* at 200-01.
[117] Although the Plaintiffs criticize LaneScan's management's attempts to contain costs, Van Wormer testified that LaneScan reduced expenses by laying off employees, winding down some consulting work, and delaying ongoing intellectual property work. Tr. 212-13.
[118] *Id.* at 120.
[119] *Id.*
[120] *Id.* at 209.

investors."[121] The "recurring theme" of feedback he received from them, though, was that LaneScan's low revenue and negative cash flow meant that it was not a suitable investment for institutional investors and that LaneScan's best bet was to seek funding from individual investors.[122] Grayson and Detwiler introduced Van Wormer to some individual investors, but they were concerned by the unwillingness of existing investors to invest more in LaneScan.[123] Indeed, none of the existing investors, including the Plaintiffs and Detwiler,[124] was willing to invest additional funds in LaneScan.[125] Overall, Van Wormer sought additional capital from December 2005 through March 2006 to no avail.[126]

By late January 2006, it was becoming clear that LaneScan could not raise capital before it would be forced to cease operations; it was projected to run out of cash by the end of March 2006.[127] Even Detwiler, who was optimistic that the groundwork had been laid for a successful company, recognized that any success would be too far in the future and even "the most optimistic timetable for a successful [fundraising] effort would still seem to leave [LaneScan] short of [its] needs."[128] On March 22, 2006, Van Wormer and Seamons spoke to various

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[121] *Id.*
[122] *Id.* at 210.
[123] *Id.*
[124] *Id.* at 123, 143.
[125] JX 90.
[126] Tr. 211.
[127] JX 154 (emails between Seamons and Detwiler from late January 2006).
[128] *Id.*

LaneScan investors, including DeWoolfson, to discuss the financial situation and the alternatives to closing LaneScan, including the possibility of merging with VSAC.[129] In a March 28, 2006 letter to LaneScan's investors in which the Merger was proposed, Seamons highlighted the company's sales disappointments, explained why fundraising efforts had failed, and reported that LaneScan was in "urgent need of capital."[130] On April 11, 2006, Seamons sent Detwiler a letter explaining that LaneScan was "days from being insolvent."[131] Seamons argued that a merger with VSAC was the best way "to preserve any investor value" in LaneScan, since a shutdown would "scatter the human capital [LaneScan] worked so hard to build and eradicate any progress [LaneScan had] made with [potential large customers]."[132] Thus, when the Merger was approved, LaneScan was facing imminent insolvency; it was unable to raise the capital it needed to survive; and it consisted of assets with little liquidation value.[133]

F. *The Process Leading to the Merger*

1. <u>The Idea of the Merger Arises</u>

LaneScan's management realized as early as late January 2006 that it was unlikely that LaneScan could raise the necessary funds to avoid shutting down

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[129] *Id.*
[130] JX 92.
[131] JX 158.
[132] *Id.*
[133] Tr. 124.

within the next few months.[134] In the same email in which Detwiler expressed this view to Seamons, he suggested they begin to think about LaneScan's "possible next steps."[135] Eventually, LaneScan's possible next steps boiled down to three options: (1) raise capital so that LaneScan could continue as an independent entity; (2) shut down and liquidate LaneScan; or (3) merge with VSAC.[136] As discussed above, the first option was attempted and failed. Liquidation was not an attractive option because LaneScan's assets had little liquidation value.[137] Ultimately, a majority of LaneScan's directors and holders of a majority of its Preferred Interests agreed to a merger with VSAC.

LaneScan began discussing the possibility of merging with ROB in late December 2005 or early January 2006 as it continued to pursue additional capital.[138] These discussions occurred among all of the Board members, including Detwiler.[139] As noted above, Seamons sent an email to Larschan and Wojack regarding the idea of merging LaneScan and the yet-unformed VSAC on January 18, 2006.[140]

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[134] *See* JX 154.
[135] *Id.*
[136] *See* JX 92 at DCP00257.
[137] Tr. 124.
[138] *Id.* at 130-31.
[139] *Id.* at 132-33.
[140] JX 36.

2. The Southard Opinion

Because LaneScan and VSAC[141] each had a group of overlapping investors and groups of investors that were not invested in the other entity, a third-party financial advisor was brought in to establish the exchange ratio.[142] Southard Financial, LLC ("Southard Financial") was retained to perform financial advisory work in connection with the Merger. Southard Financial's work is a major source of contention among the parties. Ultimately, Southard Financial recommended the exchange ratio utilized in the Merger and issued a fairness opinion on this exchange ratio, as it related to the minority investors[143] in LaneScan and VSAC.[144] Southard Financial initially concluded that the exchange ratio in the Merger should be 92.5% to VSAC and 7.5% to LaneScan,[145] but, after further discussion with Seamons, its final valuation revised the ratio to 89.5% to VSAC and 10.5% to

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[141] The initial discussions regarding the merger of LaneScan and what came to be known as VSAC occurred before VSAC was formed, but these discussions contemplated a merger of LaneScan, ROB, and VIP, which is the economic equivalent of a merger between LaneScan and VSAC. For ease of reference, "VSAC" will be used to denote either (1) VSAC or (2) ROB and VIP, together, as the case may be, when explaining the preliminary discussions regarding the Merger.

[142] Seamons Dep. 97. It is unclear who decided that a third-party financial expert should be used. *See id.*; Tr. 134-35.

[143] Southard Financial considered Pittco, Starnes, MKEIF, and MKESF to be the controlling interest holders. *See* Southard Dep. 66.

[144] JX 93.

[145] JX 72 at PIT000262.

LaneScan.[146] Unsurprisingly, it found that the exchange ratio that it, itself, calculated was fair to the minority investors.[147]

The decision to retain Southard was the result of an informal process that did not involve the input of the entire Board or a vote of the Board. Van Wormer, Seamons, and Larschan discussed potential financial advisors during a conference call;[148] however, serious consideration was not given to any candidate other than Southard Financial.[149] Seamons recommended Southard Financial because it had a good reputation and had experience working in the trucking industry.[150] Van Wormer and Larschan agreed with this recommendation.[151] In late January 2006, Seamons contacted Owen Johnson ("Johnson") of Southard Financial and asked him to provide a proposal and price quote for Southard Financial's services.[152] On February 2, 2006, Johnson emailed Seamons an engagement letter that Seamons forwarded to Van Wormer, Larschan, and Wojack.[153] In an email sent that same

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[146] JX 93 at PIT000402. The nature of the discussion that led to the change is unclear, although, in an email from Seamons to Detwiler, Seamons stated that he "convinced [Southard Financial] to move [exchange ratio] slightly during our call." JX 76. Although Pittco owned preferred interests in both LaneScan and VSAC and Seamons was a director of each, it is somewhat unusual that Seamons would negotiate for a better exchange ratio for LaneScan, since Pittco owned a larger interest in VSAC.

[147] *Id.* at PIT000406.

[148] Tr. 219. *See also id.* at 135-36.

[149] *See* Van Wormer Dep. 149-150 (stating that Van Wormer, Larschan, and Seamons did not consider retaining another financial advisor); *see also* Seamons Dep. 98-99 (testimony unclear as to which other firms, besides "Mercer," were contacted and by whom).

[150] Tr. 135.

[151] *Id.* at 219.

[152] JX 43.

[153] JX 44.

day, Van Wormer expressed his approval of the engagement letter and Seamons's suggestion that the cost of Southard Financial's services be split between LaneScan and VSAC.[154] The final cost of Southard Financial's services was $15,000.[155] The engagement letter was signed by Seamons, alone, who signed it in his capacity as chairman of ROB.[156] The Board never formally discussed the retention of a financial advisor or approved the retention of Southard.[157]

Johnson was the main point of contact between LaneScan's personnel and Southard Financial,[158] and he collected the data used in Southard Financial's analyses.[159] Doug Southard ("Southard") performed the financial modeling supporting the Southard Opinion.[160] Both Johnson[161] and Southard[162] are experienced and knowledgeable in the field of business valuation.

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[154] *Id.*
[155] JX 78.
[156] JX 46. The engagement letter was signed before the formation of VSAC.
[157] *See* Detwiler Dep. 43-44. While Detwiler became generally aware, at some point, that a financial advisor had been retained, he did not know that Southard Financial, specifically, had been retained until he received its final report (the "Southard Opinion"). *Id.*
[158] *See, e.g.*, JX 55, JX 56, JX 58 (emails between Johnson and Wojack).
[159] Johnson Dep. 18.
[160] Southard Dep. 10. The Plaintiffs attempt to cast doubt on the propriety of the scope of Southard Financial's work for LaneScan by pointing out that the Southard Opinion ultimately included an exchange ratio and a fairness opinion, but not a valuation of the two companies, as was originally contemplated by the engagement letter. As Southard explained, the deliverable that LaneScan and VSAC actually needed was an exchange ratio, not two separate valuations, since they planned to exchange shares. Southard Dep. 21-23. Furthermore, only the deliverable, not the scope of Southard Financial's work, changed, and Southard Financial did, indeed, value the two companies to determine the exchange ratio. *Id.*
[161] *See* Johnson Dep. 17-22.
[162] *See* Southard Dep.89-93.

Van Wormer (as to LaneScan),[163] Larschan (as to VSAC),[164] and Wojack (as to both LaneScan and VSAC)[165] provided information to Southard Financial. Of critical importance to the final exchange ratio were the projected future financial results of LaneScan and VSAC. Van Wormer and Larschan agreed between themselves that each would provide to Southard Financial the financial projections that they were sending to investors as part of their attempts to raise capital for LaneScan and VSAC, respectively.[166] At the time Larschan provided the VSAC projected financial information to Southard Financial, he was opposed to the Merger and was particularly concerned about VSAC's taking on LaneScan's debt.[167] The projected total sales and gross profits for VSAC that Larschan provided to Southard Financial were aggressive, to put it mildly, for a company that had no marketable product. These projections saw total sales and gross profit going from almost nothing in 2006 to over $71 million and $30 million, respectively, in 2007; increasing to over $271 million and $126 million, respectively, in 2008; and finally reaching over $411 million and $250 million, respectively, in 2009.[168] VSAC provided materially lower sales and gross profits projections to Morgan Keegan in a presentation given within weeks of the Merger

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[163] Van Wormer Dep. 170.
[164] Larschan Dep. 218-19.
[165] Wojack Dep. 133-34.
[166] Tr. 375.
[167] *Id.* at 374.
[168] JX 4 at S0066; JX 128 at S00066.

closing.[169] Larschan's testimony was inconsistent with respect to whether there were any material changes in VSAC's business that would have led to these drastically reduced, but still lofty, projections.[170]

According to the Southard Opinion, Southard Financial relied upon the accuracy of the information provided to it by VSAC,[171] but Southard Financial was not blind to the risks inherent in VSAC's business or LaneScan's prospects. As Southard testified at his deposition:

> [LaneScan's and VSAC's] situations are very unique. I mean [VSAC] is either going to be a zero or a one. . . . [i]t was going to be a one if the legislation passed and this technology was adopted. It . . . had the potential to be a substantial home run. If the legislation doesn't pass and/or isn't enforced, it's a zero. It ain't going to go anywhere.
>
> LaneScan . . . , in our opinion, was just going to muddle along. . . . It's like Facebook, it either is or it isn't. And that's kind of how we viewed [VSAC]. . . . So it's a legislative problem. . . . [With LaneScan] there's a litany of opportunities and options available to Mirrors That Move, simplistically. . . . So we see it as muddling along in a very competitive environment, vis-à-vis a regulatory environment[.][172]

There are hints that the work performed by Southard Financial might not have been as rigorous as one might expect. Southard performed most of the financial modeling while he was "on the road" in Virginia visiting another

[169] JX 6 at MS000135.
[170] Tr. 356-57, 368.
[171] JX 93 at PIT000405.
[172] Southard Dep. 34-35.

company of which he is chairman, president, CEO, and a significant investor.[173] The financial models he constructed for the LaneScan engagement were lost when his computed got a virus.[174] He had not shared these models, in electronic form, with anyone else working on the engagement or anyone associated with LaneScan or VSAC.[175] Although the Defendants highlight the fact that Johnson and Southard spoke to individuals involved in the trucking industry to understand more fully LaneScan's and VSAC's prospects, these inquiries may not have been as useful as they sound at first blush. Southard talked to "a couple buddies [he] had in the trucking business" that he "played golf with and played cards with."[176] Furthermore, he apparently did so out of intellectual curiosity, not because he considered it part of the engagement.[177] Johnson spoke with a larger number of people involved in the trucking industry and in a more formal capacity, but at least one of these individuals, Woody Welch, was an investor in VSAC, but not LaneScan, who, apparently, was aware that the Merger was being considered.[178]

The Southard Opinion was dated February 28, 2006.[179] It was never discussed at a Board meeting,[180] although it was, apparently, discussed among the

[173] *Id.* at 10-12.
[174] *Id.* at 14-15.
[175] *Id.* at 13-14.
[176] *Id.* at 35-35.
[177] *Id.*
[178] *Id.* at 133-37.
[179] JX 96.
[180] Tr. 156-57.

directors informally.[181] Seamons did inform Detwiler that Southard would be willing to discuss the results with any investor group[182] and provided him with Southard's contact information.[183]

G. *The Merger*

The Merger was proposed to LaneScan's Members in a letter from Seamons dated March 28, 2006 (the "March 28 Letter").[184] Seamons sent this letter, apparently, in his capacity as LaneScan's chairman, but he did not purport to speak for the Board as a whole,[185] which had not yet approved the Merger. In the letter, he explained LaneScan's dire financial circumstances, presented the three options available to it, and endorsed the Merger.[186] He also explained that the exchange ratio was set based upon the Southard Opinion, which was attached to the letter.[187] Furthermore, Seamons stated that "[i]n connection with the merger, and as additional consideration for the issuance of VSAC membership interests, each LaneScan member will be required to contribute such member's [Notes] to

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[181] JX 76. *See* Tr. 155-57. The Defendants tout a "three-day strategy session" attended by LaneScan's senior management and some Board members, including Detwiler, during which they, purportedly, "strategize[d]" over the Merger and discussed the Southard Opinion. Defs.' Post-Trial Br. 10. Detwiler described this meeting as something more akin to a sales pitch for ROB/VSAC. Detwiler Dep. 171-72.
[182] JX 76.
[183] JX 155.
[184] JX 92.
[185] *See id.*
[186] *Id.*
[187] *Id.*

VSAC."[188] Four other documents were attached to the March 28 Letter: (1) a Joint Action by Written Consent of the Directors and the Holders of Preferred Interests of LaneScan, LLC (the "Written Consent"); (2) the Merger Agreement; (3) a Contribution Agreement (the "Contribution Agreement"); and (4) an Allonge to Secured Notes (the "Allonge").[189] Interest holders who supported the Merger were asked to complete and return the Written Consent, the Contribution Agreement, and the Allonge.[190]

The Written Consent did not simply serve as a means for the Preferred Members and directors to approve the Merger. It also contained an amendment to the LLC Agreement whereby the Return of Capital Provision was deleted in its entirety (the "Amendment").[191] The Amendment was, apparently, sought after Detwiler's attorney informed the attorney working for VSAC and LaneScan[192] that,

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[188] *Id.*
[189] *Id.*
[190] *Id.*
[191] JX 106 (Written Consent) at LV000746. Although not relevant to this action, the Amendment also changed the definition of "Company Sale."
[192] Baker, Donelson, Bearman, Caldwell & Berkowitz, PC ("Baker Donelson") apparently served as counsel for both LaneScan and VSAC in connection with the Merger. Larschan Dep. 245 (In response to being asked if he spoke to Baker Donelson about the Amendment and recognized that Baker Donelson acted as counsel to LaneScan in the Merger, Larschan stated: "Well, they were my counsel, too. So I had discussions with them. I don't know which hat they were wearing, VIP, my personal counsel, VSAC's counsel, but I certainly had discussions with and told them under no circumstance would I go along with that."); *id.* at 240-41 (Larschan stated that that Baker Donelson advised "*us*, out of an abundance of caution to amend the [LLC Agreement]" seemingly referring to a group of people that included both LaneScan and VSAC managers or directors (emphasis added)). *See also* Van Wormer Dep. 249-20, 261-65 (explaining that Baker Donelson advised LaneScan with regard to the purported contribution of the Notes and the Amendment); Tr. 342 (Seamons testifying that Baker Donelson "represented I

in his opinion, the Merger would trigger the Return of Capital Provision.[193] The Board never discussed the Amendment before the March 28 letter was sent.[194] The Contribution Agreement and Allonge were the instruments by which the Preferred Members could contribute their Notes, including accrued interest, to VSAC.[195]

The Plaintiffs did not support the Merger and did not sign the Written Consent, Contribution Agreement, or Allonge.[196] The Amendment and the Merger were approved on April 12, 2006, by means of the Written Consent.[197] Four of the five directors consented to the Amendment and the Merger, as did holders of approximately 61% of the Preferred Interests.[198] Each of the Director Defendants consented, with Piovarcy acting for Starnes.[199] The Investor Defendants were among those Preferred Members who consented.[200] Most of the Preferred

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think a lot of the different parties" in the Merger); Seamons Dep. 182 (Baker Donelson advised LaneScan regarding the purported contribution of the Notes); *id.* at 124 (Baker Donelson suggested using a third-party to value LaneScan and VSAC and stating that Baker Donelson was Pittco's attorneys but might also have been representing LaneScan in this instance). Baker Donelson was Pittco's counsel and performed the legal work to form LaneScan, VIP, ROB, and VSAC. Pre-Trial Stipulation ¶ 109 (Pittco); Larschan Dep. ¶¶ 42-44, 75, 104, 139 (LaneScan, VIP, ROB, and VSAC).

[193] *See* JX 115 ¶ 44; Detwiler Dep. 118-20.

[194] Detwiler Dep. 118-20.

[195] JX 110 (Contribution Agreement); JX 111 (Allonge).

[196] Tr. 18-20, 74-75.

[197] Pre-Trial Stipulation ¶ 79.

[198] *Id.* at ¶ 81.

[199] JX 109.

[200] *Id.*

Members, including the Investor Defendants, also signed and returned the Contribution Agreement and the Allonge.[201]

The Plaintiffs each received a letter dated April 14, 2006, from Seamons, in his capacity as chairman of LaneScan, addressed to "LaneScan Investors" (the "April 14 Letter").[202] In the April 14 Letter, Seamons stated that the Merger received the necessary approvals and had been completed.[203] Seamons further stated that "[a]lthough you may have disagreed with the Merger and elected not to execute the Written Consent, each Preferred Member is contractually obligated pursuant to the terms of the LaneScan LLC Agreement to execute and return the Contribution Agreement and the Allonge."[204] He requested that the Contribution Agreement and Allonge be signed and returned by April 21, 2006.[205] The Plaintiffs did not sign the Contribution Agreement or the Allonge.[206]

Pursuant to the Merger Agreement, on April 13, 2006, LaneScan Merger Sub, LLC, a Delaware LLC and a wholly owned subsidiary of VSAC, merged with and into LaneScan, with LaneScan as the surviving entity as a subsidiary of VSAC.[207] As a result of the Merger, VSAC acquired all of the outstanding Preferred Interests and Common Interests in LaneScan, and LaneScan became a

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[201] Pre-Trial Stipulation ¶¶ 86-101.
[202] JX 113.
[203] *Id.*
[204] *Id.*
[205] *Id.*
[206] Tr. 18-19, 74-75.
[207] Pre-Trial Stipulation ¶ 82.

wholly owned subsidiary of VSAC.[208] According to Exhibit B to the Merger Agreement, Dawson's 7.96% Preferred Interest in LaneScan was converted into a 0.793% preferred interest in VSAC, and DeWoolfson's 1.99% Preferred Interest in LaneScan was converted into a 0.198% preferred interest in VSAC.[209] According to the parties, the Plaintiffs' Notes were cancelled in conjunction with the Merger.[210] LaneScan is still operating; however, it produces little revenue.[211]

IV. CONTENTIONS

It is clear that the Plaintiffs believe the Merger was approved by a conflicted Board that utilized an insufficient process to obtain an unfair price for the Preferred Interests in a self-dealing transaction. But, because LaneScan was an LLC and the fiduciary duties of its directors, officers, and interest holders were limited by the LLC Agreement, the Plaintiffs cannot bring a straightforward duty of loyalty claim. Instead, they focus on two particular aspects of the transaction that they find especially egregious and assert a panoply of claims related to each. For good measure, they bring fiduciary duty claims using what little portions of the standard fiduciary duties they contend remained.

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[208] *Id.* at ¶ 83.
[209] *Id.* at ¶ 84.
[210] *Id.* at ¶ 102.
[211] Tr. 162.

First, the Plaintiffs take issue with the purported compelled contribution of their Notes[212] and the purported subsequent cancellation of these Notes. The Defendants assert that the LLC Agreement empowered the Board to accomplish the Compelled Contribution. Furthermore, the Defendants argue, pursuant to the Drag-Along Provision, the Plaintiffs were required to contribute their Notes as part of the Merger. The Plaintiffs challenge the Defendants' interpretation of the LLC Agreement and the Drag-Along Provision. They counter that the Drag-Along Provision cannot be used to effect a Compelled Contribution. The fact that the Notes are debt instruments, not equity, is central to the Plaintiffs' argument.

The Plaintiffs assert numerous claims related to the Compelled Contribution. They bring multiple breach of contract claims. Two of these contract claims are brought against the Director Defendants and the Investor Defendants and relate to alleged breaches of two fiduciary duties that the Plaintiffs assert were specifically preserved by the LLC Agreement—the duty of care and the duty not to commit intentional misconduct. The Plaintiffs also claim that the terms of the Notes were breached because the Notes did not allow for a Compelled Contribution. The Plaintiffs also assert that the Notes experienced an event of default due to the

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[212] When the Court is referring to the purported compelled contribution and cancellation of the Notes that, allegedly, was effected in connection with the Merger, it will refer to this compelled contribution and cancellation as *the* "Compelled Contribution." When the Court is referring to a hypothetical compelled contribution of a debt instrument in connection with a hypothetical merger, it will refer to such a compelled contribution as a "Compelled Contribution."

written statements of various LaneScan employees and directors that LaneScan was nearing insolvency at the time of the Merger. The Plaintiffs argue that the LLC Agreement contained an implied covenant that its signatories, including the Investor Defendants, would not act to impair the Plaintiffs' rights in the Notes. An aiding and abetting claim is brought against various Defendants for their alleged roles in the fiduciary-duty-related breach of contract and the breach of the implied covenant. The Plaintiffs also allege that the Notes were converted and/or tortiously interfered with by the Defendants. In the event the Court does not grant them monetary damages under any of the preceding claims, the Plaintiffs ask that the Court issue a declaratory judgment declaring that the Notes are still outstanding. The Plaintiffs also ask that the Court place a constructive trust on LaneScan's assets because, they allege, the Defendants interfered with their ownership of the Notes, including the security interests granted under the Security Agreement. Finally, the Plaintiffs seek an award of attorneys' fees and expenses for those costs associated with their Note-related claims under both contractual and common law theories.

Second, the Plaintiffs argue that the elimination of the Return of Capital Provision pursuant to the Amendment was improper. In response, the Defendants reply, generally, that the Amendment was expressly permitted by § 12.4 of the LLC Agreement. The Plaintiffs assert numerous claims related to the Amendment.

The Plaintiffs argue that the Director Defendants and the Investor Defendants breached their fiduciary duties, specifically the duty of care and the duty to abstain from intentional misconduct, and committed fiduciary-duty-related breaches of contract by approving the Amendment. Furthermore, they argue that the Amendment constituted a breach of the implied covenant. An aiding and abetting claim is brought against various Defendants for their alleged roles in the breach of fiduciary duties, fiduciary-duty-related breach of contract, and the breach of the implied covenant.

Third, the Plaintiffs, assert more general breach of fiduciary duty claims against the Director Defendants related to their approval of the Merger and the process they employed in doing so.

Fourth, the Plaintiffs assert a breach of fiduciary duty claim against Van Wormer in his capacity as CEO of LaneScan. They contend that, concerning officers, the LLC Agreement left in place a broader array of fiduciary duties. In reply, the Defendants argue that, while officers owed a broader range of fiduciary duties to *LaneScan*, the duties they owed the Preferred Members were limited to the same extent as were the duties of directors.

In addition to the arguments noted above, the Defendants contend that the Plaintiffs' claims are barred by the doctrine of laches. The Defendants also

advance many claim-specific arguments that the Court will address, as necessary, throughout this Memorandum Opinion.

V. ANALYSIS

A. *Were the Investor Defendants a Control Group?*

The Plaintiffs suggest that the Investor Defendants constituted a control group.[213] This Court has recognized that

> a number of [interest holders], each of whom individually cannot exert control over the [entity] (either through majority ownership or significant voting power coupled with formidable managerial power), can collectively form a control group where those [interest holders] are connected in some legally significant way—e.g., by contract, common ownership, agreement, or other arrangement—to work together toward a shared goal.[214]

Control groups are accorded controlling interest holder status, and their members owe fiduciary duties to the minority interest holders of the LLC they control.[215]

The Court concludes that the Investor Defendants did not constitute a control group. The Investor Defendants were: Pittco, Starnes, MKESF, MKEIF, Garner, and Jackson Capital. The Plaintiff has simply not proven that there was any legally significant connection between these parties. At best, the Plaintiff has shown that Pittco and Starnes stood on both sides of the Merger. But, with regard to the Merger, the other members of the alleged control group did not stand on both sides

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[213] *See* Opening Br. (referring to the Investor Defendant as the Controlling Interest Holders); Pls.' Post-Trial Reply Br. ("Reply Br.") (same). *See also* Pre-Trial Stipulation ¶ 110.

[214] *Dubroff v. Wren Hldgs., LLC*, 2009 WL 1478697, at *3 (citing *In re PNB Holding Co. S'holders Litig.,* 2006 WL 2403999, at *10 (Del. Ch. Aug. 18, 2006)).

[215] *Dubroff v. Wren Hldgs., LLC*, 2011 WL 5137175, at *7 (Del. Ch. Oct. 28, 2011).

of the transaction and actually experienced the same degree of dilution as the Plaintiffs. Furthermore, alone, a showing of "parallel interests" does not support a conclusion that the shareholders were part of a control group.[216] Additionally, at the time of the Merger, Pittco and Starnes, alone, controlled only 37% of the Preferred Interests and only two of the five seats on the Board; therefore, even if this Court were to find that there was some legally significant connection between them, they could not, collectively, have asserted control over LaneScan.

B. *The Notes Claims*

The Plaintiffs bring multiple claims against the Defendants related to the purported Compelled Contribution (the "Notes Claims"), which are described and analyzed below.

1. Did the Defendants Have the Power to Effect the Purported Compelled Contribution?

At the heart of the Notes Claims and the Defendants' related defenses is a fundamental disagreement over whether the Plaintiffs could be forced to contribute their Notes in connection with the Merger. First, the Defendants argue that, generally, a Compelled Contribution may be effected in connection with a merger, without regard as to whether that power is enshrined in the LLC Agreement or any other operable document. Second, the Defendants contend that, in this case, the LLC Agreement, in the Drag-Along Provision, *did* authorize the Compelled

[216] *See Dubroff v. Wren Hldgs., LLC*, 2009 WL 1478697, at *3.

Contribution. The Plaintiffs argue that the Defendants conflate equity and debt and that, although "parties to contracts are free to provide that contractual rights and obligations will not survive a merger, *they must do so in clear and unambiguous terms*."[217] In this case, according to the Plaintiffs, neither the LLC Agreement nor any other contract provided in "clear and unambiguous terms" for elimination of the Notes in connection with a merger.

In support of their first argument, the Defendants contend that a Compelled Contribution may be achieved in connection with a merger because mergers may eliminate the "vested rights"[218] of the shareholders of pre-merger entities, including rights "in the nature of a debt" or "any other matured claim."[219] The Defendants argue that, generally, one's status as an equity holder in an entity subjects any of one's vested rights, related to the entity, to defeasance in a properly approved merger, without any requirement that the equity holder have agreed—either before or in conjunction with the merger—to the elimination of the right in a merger. The Defendants cite various cases they claim support this proposition.[220] Furthermore, the Defendants contend that Delaware courts allow the elimination of vested right

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[217] Pls.' Reply Br. 4 (quoting *Law Debenture Trust Co. of N.Y. v. Petrohawk Energy Corp.*, 2007 WL 2248150 (Del. Ch. Aug. 1, 2007), *aff'd*, 947 A.2d 1121 (Del. 2008) (TABLE)) (emphasis in Plaintiffs' brief, but not in quoted opinion).
[218] Defs.' Post-Trial Br. 16 (citing *Rothschild Int'l Corp. v. Liggett Gp. Inc.*, 474 A.2d 133 (Del. 1984); *Shields v. Shields*, 498 A.2d 161 (Del. Ch. 1985)).
[219] *Id.* at 18 (quoting *Langfelder v. Universal Labs., Inc.*, 68 F. Supp. 209, 211 (D. Del. 1946) ("*Langfelder I*"), *aff'd,* 163 F.2d 804 (3d Cir. 1947) ("*Langfelder II*")).
[220] *Langfelder I*, 68 F. Supp. at 209; *Rothschild*, 474 A.2d at 133; *Federal United Corp. v. Havender*, 11 A.2d 331 (Del. 1940); *Shields*, 498 A.2d at 161.

in connection with mergers because, otherwise, "mergers involving financially troubled business[es], such as LaneScan, would be unlikely if the acquiring entity were forced to satisfy all vested rights before completing the merger."[221]

All of the cases cited by the Defendants involved rights eliminated in a merger, but, crucially, all of these rights arose from a shareholder's equity interest in the corporation.[222] The cases cited by the Defendants, particularly *Havender*

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[221] Defs.' Post-Trial Br. 17 (citing *Havender*, 11 A.2d at 338).

[222] The line of cases upon which the Defendants rely begins with *Havender*. In that case, the plaintiffs challenged a merger on the basis that, as a result of the merger, their preferred stock was converted into other securities without payment of the preferred stock's accrued dividends. *Havender*, 11 A.2d at 332. The Supreme Court ruled against the plaintiffs, concluding that a shareholder's rights "attached to the shares" are subject to defeasance in a properly approved merger. *Id.* at 334. As examples of such rights, the Supreme Court listed "rights in respect of voting, options, preferences and dividends." *Id.* All of these rights traditionally derive from or are tied to equity ownership. The Supreme Court stated that, with regard to accrued dividends, a shareholder's "contract [, the charter,] has informed him that the right is defeasible; and with that knowledge the stock was acquired." Further buttressing the link between the power of a merger to eliminate a shareholder's rights and those rights' relation to the shareholder's equity interest, the Supreme Court in *Havender* stated that a dissatisfied shareholder in the plaintiffs' position may seek redress in the form of an appraisal, not by vetoing the merger. *Id.* at 334-35. In addition, referring to what was then § 60 of the General Corporation Law (now 8 *Del. C.* § 259) the Supreme Court stated that finding that a merger could not extinguish accrued dividends would "compel the recognition of such unpaid dividends as a debt or liability of the corporation enforceable against the resulting corporation." *Id.* at 335. Indeed, the Supreme Court wrote at length to distinguish holders of preferred stock and accrued dividends from "creditor[s]," "holder[s] of liens," "debts," and "liabilities" "as [those] word[s are] usually understood," the latter terms relating to obligations of a corporation that survive a merger under 8 *Del. C.* § 259. *Id.* at 335-36. While the Supreme Court spoke of "creditor[s]," "holder[s] of liens," "debts," and "liabilities" (referred to below as "[t]he words and terms") as usually referring to persons external to the corporation and those external persons' rights, the Supreme Court made it clear that the true determinant of whether a right is defeasible is not a person's general status as a shareholder or non-shareholder, but whether *the right in question* springs from her status as a shareholder:

> The words and terms [of 8 *Del. C.* § 259] are readily to be understood as referable to persons external to the corporation, and to debts, liabilities and duties due from the corporation to them, and not to *those internal liabilities and duties of the corporation to the shareholder which spring from that relationship*.

Id. at 336.

Next in the line of cases came *Langfelder I*. In that action, the plaintiffs sought damages for breach of the defendant Vadsco Sales Corporation's ("Vadsco") charter. The plaintiffs were owners of Vadsco preferred shares that, in addition to the normal preferential rights, also granted preferred shareholders the following right (the "Right"):

> In the event of any reduction in the stock of the corporation resulting in a reduction of the preferred stock either as to number of shares or as to the par value thereof . . ., the holders of the shares of said preferred stock affected by such reduction and to the extent thereof . . . shall be entitled to receive and shall be paid an amount in cash not less than one hundred and ten per cent (110%) of the amount of the reduction . . . and . . . all cumulated and unpaid dividends thereon and a sum equal to a dividend at the rate of seven per cent (7%) per annum from the last dividend date to the date of such reduction or voluntary dissolution.

Langfelder I, 68 F. Supp. at 209-10. Vadsco was recapitalized through a stock for stock merger with a wholly owned subsidiary. *Id.* at 210. While the plaintiffs claimed that the Right was "a divisible and separate contract," it was found in Vadsco's charter. *Id.* at 210-212. The District Court rejected the plaintiffs' argument that the Right was a separate contract, and the District Court analogized the Right to the right of preferred shareholders to receive accrued dividends, which the Supreme Court in *Havender* concluded was defeasible by a merger. *See id.* at 212. The District Court emphasized the link it saw between the Right and the preferred stock itself by stating that, as recognized in *Havender*, the appropriate remedy for the plaintiffs was appraisal. *Id.* at 212-13.

In affirming the District Court's decision *Langfelder I*, the Third Circuit, citing *Havender*, made it clear that the power of a merger to eliminate a shareholder's rights turns on whether those rights spring from his status as a shareholder:

> "So long as the *rights of the plaintiffs* in the instant case *lie within the confining box of stock ownership* . . . the principle enunciated . . . in the *Havender* case would apply unless the reorganization was . . . [deemed] unfair[.] [. . .]
>
> Only by giving the plaintiffs *a status equivalent to that of creditors can they escape from the box of the stockholder-corporation relationship* and from the effects of *Havender*."

Langfelder II, 163 F.2d at 808 (emphasis added). The Third Circuit went on to conclude that the Right was "incidental to [the plaintiffs'] stock ownership," and, therefore, "would fall within the all-inclusive scope of the *Havender* doctrine and would be converted with all other contractual rights *inherent in stock ownership*." *Id.* at 808 (emphasis added).

Havender, *Langfelder I,* and *Langfelder II* are not reconcilable with the Defendants' first argument that, without any clear and unambiguous predicate contract language alerting the Preferred Members to the possibility that the Notes could be subject to a Compelled Contribution, LaneScan could simply force Preferred Members to contribute their Notes in connection with the Merger. Not only does the express language of those opinions compel this conclusion, but so does the fact that the Supreme Court in *Havender* and the District Court in *Langfelder I* rely on the availability of the appraisal remedy to support their conclusions that the rights at issue in could be eliminated by a merger. Appraisal is not a remedy available to debt holders. *See* 8 *Del. C.* § 262.

and the Third Circuit's opinion in *Langfelder II*, serve to refute, not support, the Defendants' argument that, generally, an equity holder may be compelled to forgo his rights in a debt instrument in connection with a merger, based solely upon his status as an equity holder and without having entered into a contract with language providing that such rights would not survive a merger. As this Court has previously recognized, although "parties to contracts are free to provide that

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Rothschild involved claims of Liggett Group, Inc. ("Liggett") preferred shareholders who tendered their shares or were cashed-out in a merger at a price less than the liquidation preference of the preferred shares stated in Liggett's charter. *Rothschild*, 474 A.2d at 136. The Supreme Court found that the preference rights were governed by Liggett's charter and that the liquidation preference was not triggered by the tender offer and merger. *Id.* The Supreme Court went on to state: "It is equally settled under Delaware law that minority *stock interests* may be eliminated by merger. And, where a merger of corporations is permitted by law, a *shareholder's preferential rights* are subject to defeasance. Stockholders are charged with knowledge of this possibility at the time they *acquire their shares*." *Id.* at 136-37 (citing *Langfelder I,* 68 F. Supp. at 209; *Havender*, 11 A.2d at 338) (emphasis added). Thus, following the line of thought developed in *Langfelder I*, *Langfelder II*, and *Havender*, the Supreme Court tied the ability to eliminate a shareholder's preferential rights to the fact that these rights sprung from an equity interest in the corporation.

Shields is different from *Havender, Langfelder I, Langfelder II,* and *Rothschild* in that it did not involve a right that was "abolish[ed]" by a merger, but, instead, it involved a right that was merely "mooted" by a merger. *Shields*, 498 A.2d at 168. In *Shields* the plaintiff sought to enforce a right of first refusal that arose from a shareholders agreement. *Id.* The shares subject to the plaintiff's right of first refusal were exchanged for shares of another company in a stock for stock merger, and the plaintiff argued that this merger triggered his right of first refusal. *Id.* at 165. The Court held that the plaintiff's interpretation of the shareholders agreement was incorrect because "[t]he statutory conversion of stock in a constituent corporation into stock in the surviving corporation that is effected by a stock for stock merger ought not be construed to constitute a sale, transfer or exchange of that stock for purposes of an agreement among shareholders restricting their power to transfer their stock." *Id.* at 167 (citations omitted). In dicta, discussing *Havender* and *Langfelder I*, the Court explained that mergers could "abolish" vested rights. *Id.* at 168. The Court also explained that the right was "mooted" not "abolish[ed]" by the merger because the subject of the shareholders agreement (the stock) ceased to "exist legally" after the merger. *Id.* Therefore, the contract right in question was not seized in conjunction with or eliminated by the merger, but merely rendered empty as a consequence of the merger.

contractual rights and obligations will not survive a merger, they must do so in *clear and unambiguous terms*."[223]

Therefore, the Court must first determine if the Plaintiffs' rights relative to the Notes sprang from the Plaintiffs' Preferred Member/LLC relationship,[224] or, stated in another manner, whether these rights could be found to have "[lain] within the confining box of [Preferred Interest] ownership."[225] If the Court concludes that the Plaintiffs' rights relative to the Notes did not spring from the Plaintiffs' Preferred Member/LLC relationship, then the Court must determine whether the Notes themselves or any other operable document stated in clear and unambiguous terms that the Notes could be eliminated in connection with a merger.[226]

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[223] *Petrohawk*, 2007 WL 2248150, at *9 n.27 (citing *Western Airlines, Inc. v. Allegheny Airlines, Inc.,* 313 A.2d 145 (Del. Ch.1973) (emphasis added)). The general rule for LLCs—which, as recognized above, may be altered by contract—is found at 6 *Del. C.* § 18-209(g) and states, with regard to debt and liabilities:

> all rights of creditors and all liens upon any property of any of said domestic [LLCs] and other business entities shall be preserved unimpaired, and all debts, liabilities, and duties of each of the said domestic [LLCs] and other business entities that have merged or consolidated shall henceforth attach to the surviving or resulting domestic [LLCs] or other business entity, and may be enforced against it to the same extent as if said debts, liabilities and duties had been incurred or contracted by it.

6 *Del. C.* § 18-209(g); *see also* 8 *Del. C.* § 259 (similar statutory language for corporations).

[224] *Havender*, 11 A.2d at 336.

[225] *Langfelder II*, 163 F.2d, at 808.

[226] The Court finds that the Plaintiffs' rights relative to the Notes are contractual rights, regardless of whether they are found to have sprung from Preferred Member/LLC relationship or not. Therefore, the clear and unambiguous standard is the correct standard to apply if the Plaintiffs' rights relative to the Notes are found to have not sprung from the Preferred Member/LLC relationship.

The Court concludes that the Plaintiffs' rights relative to the Notes did not spring from their Preferred Member/LLC relationship with LaneScan. Although the Plaintiffs owned an equity stake in LaneScan through their ownership of Preferred Interests and, therefore, had a Preferred Member/LLC relationship with LaneScan, they separately owned LaneScan debt through their ownership of Notes, and this established a separate Note holder/debtor relationship with LaneScan. While the Defendants do come close to conflating the Notes and Preferred Interests in some of their arguments,[227] no party actually argues that the Notes did not represent a separate set of rights from those granted by the Preferred Interests.[228] For example, Note holders, in their capacities as Note holders, did not have the

[227] The Defendants' argue that the Subscription Agreement, Notes, Security Agreement, and LLC Agreement should be "treat[ed] . . . as one contract." Defs' Br. 19. Although the Court need not and does not rule on this argument, it notes that many factors counsel against treating these various agreements as one contract: they were executed by the Plaintiffs on different dates; they are governed by the laws of different states; they concern different rights of the Plaintiffs (those related to their Preferred Interests and those related to their Notes); and both the LLC Agreement and Subscription Agreement contain an integration clause. Ultimately, the Defendants ask the Court to treat these agreements as one contract because they want the Court to construe all of agreements together. The Court does not understand this argument as positing that the Plaintiffs rights relative to the Notes spring from the Note holders' separate equity investment; it merely contends that these agreements should be viewed as one large contract and construed together. Even if these agreements were viewed as one contract and construed together, the Court concludes that this one contract still would have established two separate sets of rights (equity and debt) and two separate, corresponding relationships between the Plaintiffs and LaneScan (Preferred Member/LLC and Note holder/debtor).

[228] In fact, at Post-Trial Argument, counsel for the Plaintiffs expressly denied that the Notes were a "stalking horse" for an equity interest in LaneScan. Tr. (Post-Trial Oral Arg.) 12-14. One may wonder whether a court applying the tax code or the Bankruptcy Code would recognize the Notes as debt, given that they were issued only to investors who also purchased equity interests, were issued to those investors at, essentially, the same time the investors purchased their equity interests, and were issued to investors in proportion to their equity interests. But, for this Court's purposes, such questions are merely academic, as it is applying Delaware law and no party has argued that the Notes were a sham to disguise equity with a façade of secured debt.

right to participate in LaneScan's governance[229] or share in its profits,[230] but Note holders (and not Preferred Members, in their capacities as Preferred Members) were entitled to interest, scheduled repayment of their principal, and a security interest in LaneScan's assets.[231] Additionally, both the PPM and the Subscription Agreement described the Units as consisting of two separate investments: "[a] preferred interest in the company" and "a secured promissory note of the Company."[232] Finally, Schedule A of the LLC Agreement, which summarized each Member's equity investment, reflected only half of each Preferred Member's/Note holder's total investment as an equity investment; the other half was attributed to their Notes.[233]

Having concluded that the Plaintiffs' rights in the Notes did not spring from their Preferred Member/LLC relationship with LaneScan, the Court must next determine whether the Notes themselves or any other operable document stated in *clear and unambiguous terms* that the Notes could be eliminated in connection with a merger. The Court concludes that no operable document, including the Notes and the LLC Agreement, stated as such in clear and unambiguous terms.

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[229] *See* LLC Agreement at § 3.1(b)-(c) (granting Preferred Members and Common Members limited voting rights).
[230] *See* LLC Agreement at arts. V, VI.
[231] *See* Notes; Security Agreement.
[232] PPM; Subscription Agreement. *See also* Defs.' Pre-Trial Br. (recognizing that the Subscription Agreement explains the Units as being composed of two separate investments, as described above).
[233] *See supra* Part III.A.

The Defendants do not argue that any provision of the Notes themselves, the Security Agreement, or any other agreement, aside from the LLC Agreement, empowered them to effect the Compelled Contribution. The Court, likewise, concludes that no agreement before the Court—the LLC Agreement excepted, for the moment—stated in clear and unambiguous terms that the Notes could be eliminated in connection with a merger.

The Defendants do contend that the LLC Agreement authorized them to compel the Plaintiffs to contribute their Notes in connection with the Merger. The Defendants argue that this power has two sources in the LLC Agreement. The Defendants' first argument is difficult to understand and even more difficult to summarize.[234] A detailed analysis of this argument is not necessary, however,

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[234] *See* Defs' Pre-Trial Br. 18-22. This argument relies heavily on the Defendants' contention that the Subscription Agreement, the Notes, the Security Agreement, and the LLC Agreement must be construed together. *See* Defs' Pre-Trial Br. 10-12; Defs' Post-Trial Br. 18-20. According to the Defendants, provisions in the Subscription Agreement made the Notes subject to the LLC Agreement, and, therefore, the Notes could only be "disposed of in accordance with the LLC Agreement." Defs' Pre-Trial Br. 21. In support of this assertion, however, the Defendants cite many provisions of the Subscription Agreement that refer to "Members," "Preferred Interests," and "Interests," all defined terms—except "Interests," which appears to be an inadvertently shortened version of "Preferred Interests"—that did not directly relate to the Notes. *See* Defs' Pre-Trial Br. 19-20; Subscription Agreement; LLC Agreement at § 1.1; *supra* Part II n.5 (explaining definition of "Member"). "Note" was a separately defined term in the Subscription Agreement. Subscription Agreement at 1. In fact, § 1 of the Subscription Agreement, quoted by the Defendants, would be most easily understood as *limiting* the reach of the LLC Agreement to only the rights and obligations springing from the Preferred Interests. *See* Subscription Agreement at § 1 ("The Subscriber hereby adopts, accepts and agrees . . . to be bound by all the terms and provisions of the [LLC] Agreement and to perform all obligations and duties therein imposed *upon Member with respect to the Preferred Interests* subscribed for hereby[.]" (emphasis added)). A portion of § 5 of the Subscription Agreement comes closest to tying the Notes to the LLC Agreement in the manner suggested by the Defendants. *See id.* § 5 ("The Subscriber further understands that his/her ability to transfer the Preferred Interests and the

because, according to the Defendants, the conclusion of this first argument is that: "Ultimately, the Board's authority to direct the contribution of the Notes is a matter of straightforward contractual interpretation *resulting from the broad authority conveyed to the LaneScan Board in the LLC Agreement*."[235] The short answer to why this argument fails is that the applicable standard requires that the authority to direct the contribution of the Notes be stated in *clear and unambiguous terms*. Such power simply cannot be found hiding within "the broad authority conveyed to the LaneScan Board." So, by merely relying on the Board's supposed "broad authority" and having failed to point the Court to clear and unambiguous terms authorizing the Board to effect the Compelled Contribution, this argument fails.

According to the Defendants' second argument, the Drag-Along Provision of the LLC Agreement authorized the Board to effect the Compelled Contribution. The Drag-Along Provision states, in its entirety:

Note is also severely restricted by the [LLC] Agreement and, under most circumstances, the Subscriber cannot sell, assign, pledge, create a security interest in or otherwise transfer the Preferred Interests and the Note[.]"). Regardless, the Defendants contend that the Notes are subject to the LLC Agreement and, therefore, may only be disposed of in accordance with the terms of the LLC Agreement. As the Defendants admit, the LLC Agreement "makes no explicit reference to the Notes." Defs.' Pre-Trial Br. 20; *see also* LLC Agreement. It is therefore hard to understand how the LLC Agreement could contain clear and unambiguous language authorizing a Compelled Contribution, if the LLC Agreement does not even explicitly refer to the Notes. Any provision that grants the Board some general power is inadequate as a matter of law, as set forth in the text, to authorize it to effect a Compelled Contribution. Indeed, the Defendants' first argument finds the Board's authority to effect a Compelled Contribution within a "broad authority conveyed to [the Board] in the LLC Agreement" and, for this reason, this argument fails as a matter of law. Defs' Pre-Trial Br. 22.

[235] Defs' Pre-Trial Br. 22 (emphasis added).

> If a majority of the holders of Preferred Interest[s] desire to effect a Company Sale, then notice shall be sent to each of the other Members, in writing, of such desire and the terms and conditions of such proposed sale. Notwithstanding any other provision of [the LLC] Agreement, each such other Member *shall take all necessary and desirable actions reasonably requested* in connection with the consummation of such Company Sale. In furtherance of, and not in limitation of the foregoing, in connection with such a Company Sale, each Member will (i) consent to and raise no objections against the Company Sale or the process pursuant to which it was arranged, (ii) waive any dissenter's rights and other similar rights, and (iii) *execute all documents containing the same terms and conditions as those executed by holders of Preferred Interest*[*s*] and as *reasonably directed* by holders of Preferred Interest[s].[236]

The Plaintiffs do not argue that the Merger was not a "Company Sale" or that they were not "Members," as those terms were defined by the LLC Agreement, and the Court accepts that the Merger was a "Company Sale" and the Plaintiffs were "Members."[237] Even so, in no way does the Drag-Along Provision state in clear and unambiguous terms that the Board or a majority of the Preferred Members have the ability to effect a Compelled Contribution. Pursuant to the Drag-Along Provision, the Plaintiffs agreed to "take all necessary and desirable actions reasonably requested in connection with the consummation of [a] Company Sale."[238] Specifically, the Plaintiffs agreed to "execute all documents containing the same terms and conditions as those executed by holders of Preferred Interest[s]

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[236] LLC Agreement at § 10.6 (emphases added).

[237] *See id.* at § 1.1 (definition of "Company Sale" includes any sale of LaneScan in which a person or entity acquires 50% or more of the outstanding Membership Interests and definition of "Member" includes those listed on Schedule A, upon which the Plaintiffs were listed).

[238] *Id.* at § 10.6.

and as reasonably directed by holders of Preferred Interest[s]."[239] This type of broad, general language does not meet the "clear and unambiguous" standard that contract language authorizing a Compelled Contribution must meet.

Finally, the Defendants, perhaps, suggest that a Compelled Contribution was appropriate and permissible because LaneScan was approaching insolvency and the Plaintiffs' Preferred Interests and Notes would have lost all of their value had the Merger not been accomplished. The cases the Defendants cite relate to the Court's assessment of whether a director has fulfilled his fiduciary duties or relate to fair value appraisals.[240] While the context in which a director acts must be taken into account when determining if that director has breached his fiduciary duties,[241] a company's financial distress does not grant its directors or owners powers they do not otherwise possess.

In sum, none of the Defendants individually or collectively had the power to compel the Plaintiffs to contribute their Notes in connection with the Merger. While the Defendants may have claimed that the Notes were contributed and

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[239] *Id.*

[240] *See* Defs.' Post-Trial Br. 23-26 (citing *S. Muoio & Co. LLC v. Hallmark Entm't Invs. Co.*, 2011 WL 863007 (Del. Ch. Mar. 9, 2011) (entire fairness); *In re Hanover Direct, Inc. S'holders Litig.*, 2010 WL 3959399 (Del. Ch. Sept. 24, 2010) (entire fairness and statutory appraisal); *Wayne Cty. Employees' Ret. Sys. V. Corti*, 2009 WL 2219260 (Del. Ch. July 24, 2009) (duty of loyalty); *In re Vision Hardware Gp., Inc.*, 669 A.2d 671 (Del. Ch. 1995), *aff'd*, 676 A.2d 909 (Del. 1996) (appraisal).

[241] *See Corti*, 2009 WL 2219260, at *10.

cancelled,[242] they simply never possessed the power to force the Plaintiffs to contribute their Notes, and the Plaintiffs never executed any documents pursuant to which they voluntarily contributed the Notes. Thus, the Notes have always remained outstanding, and they are still outstanding at this moment. Therefore, the Court concludes that the appropriate remedy is a declaratory judgment that the Plaintiffs' Notes have been valid, enforceable, and outstanding since the Notes' issuance to the Plaintiffs and remain valid, enforceable, and outstanding today.[243] The Security Agreement, likewise, is and has been since its execution valid and enforceable. The Court will assess the Plaintiffs' remaining Notes-related claims below in light of this ruling.

2. Conversion

The Plaintiffs assert that the Defendants converted their Notes. This claim is premised upon the Plaintiffs' contentions that the Defendants "exercised dominion over [the Plaintiffs'] Notes by causing them to be contributed to VSAC in the Merger" and "authorize[ed] their unilateral cancellation by [LaneScan]."[244] As

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[242] In the Pre-Trial Stipulation, the Plaintiffs and the Defendants stipulated that "[a]s a result of the Contribution Agreement, the outstanding [Notes] issued to Preferred Interest holders were cancelled." Pre-Trial Stipulation ¶ 102. Although the Plaintiffs argued otherwise, *see* Tr. (Post-Trial Oral Arg.) 46, the stipulation would not apply to the Plaintiffs' Notes because they never executed the Contribution Agreement, and, as discussed above, the Defendants were not authorized to effect the Compelled Contribution.

[243] In the alternative to an award for damages, the Plaintiffs sought a declaratory judgment "that the Notes remain valid and outstanding." Pre-Trial Stipulation 3 (Count VI).

[244] Pls.' Pre-Trial Br. 17. *See also* Pls.' Opening Br. 29 (stating that the "Defendants exercised dominion over [the Plaintiffs'] Notes by causing them to be contributed to VSAC in the

explained above, this Court has ruled that the Plaintiffs' Notes were not contributed or cancelled in the Merger and were, and are still, outstanding. Therefore, the Plaintiffs' conversion claim, which is premised upon their Notes having been contributed and cancelled, fails.

3. Breach of Contract

The Plaintiffs' Notes-related breach of contract claim largely mirrors their conversion claim. They argue that the purported Compelled Contribution constituted a breach of contract because § 3.1 of the Notes contained several provisions protecting their rights in the Notes from waiver or discharge, unless waiver was given in writing.[245] The Plaintiffs did not sign the Contribution Agreement and Allonge, and, yet, according to the Plaintiffs, their Notes were contributed and cancelled, and, thus, the Notes were breached. As with the Plaintiffs' conversion claim, this claim fails because this Court has ruled that the Plaintiffs' Notes were not contributed or cancelled in the Merger and were, and are still, outstanding.

4. Tortious Interference

The Plaintiffs' claim that the Defendants tortiously interfered with the Plaintiffs' Notes is also based on the contention that the Plaintiffs' Notes were

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Merger"); Pls.' Reply Br. 2-4 (stating that the Plaintiffs' Notes were "wipe[d] out" in the Merger, "confiscated," and "not subject to relinquishment or cancellation without [the] Plaintiffs' consent").

[245] *See* Pls.' Pre-Trial Br. 16-17; Pls.' Opening Br. 24-28; Pls.' Reply Br. 2-7.

contributed and cancelled in connection with the Merger.[246] Therefore, for the reasons explained above, this claim fails, too.

5. Intentional Misconduct

Although the Plaintiffs' intentional misconduct arguments seem focused on the broader merger process, it is possible that one could view an intentional misconduct claim[247] as having been fairly raised with respect to the Notes.[248] Any such claim fails for the reasons explained *infra* Part V.D.

6. Implied Covenant of Good Faith and Fair Dealing

The Plaintiffs argue that the Defendants violated the implied covenant of good faith and fair dealing in the LLC Agreement by improperly effecting the purported Compelled Contribution.[249] This claim fails for the same reason the Plaintiffs' conversion, breach of contract, and tortious interference claims failed. To the extent the Plaintiffs' asserted a claim for a more generalized bad faith breach of the implied covenant related to their Notes, such a claim fails for the same reasons that the Plaintiffs' Notes-related intentional misconduct claim fails.

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[246] *See* Pls.' Pre-Trial Br. 18; Pls.' Opening Br. 30; Pls.' Reply Br. 13-14 ("The [tortious interference] claim turns on the cancellation of the [Plaintiffs'] Notes in connection with [the Merger].").

[247] *See infra* Part V.D.1 and Part V.D.3 for the Court's explanation of the Plaintiffs' intentional misconduct claim, which they style as both a breach of the LLC Agreement and a breach of fiduciary duty.

[248] *See* Pre-Trial Stipulation 2 (describing Count I as "assert[ing] that Defendants engaged in intentional misconduct in violation of the terms of the LaneScan LLC Agreement, [the] Notes and [the] [S]ecurity [A]greement").

[249] *See* Pls.' Pre-Trial Br. 24-25; Pls.' Reply Br. 28-29.

7. Notes in Default

The Plaintiffs contend that their Notes are in default, and, as a result, they are entitled to immediate payment of the entire face vale of their Notes, with interest. Events of default are set for in Article 2 of the Notes. The Plaintiffs rely on § 2.1(b)(v) under which an event of default has occurred "[i]f, pursuant to or within the meaning of the United States bankruptcy code or any other federal or state law relating to insolvency or relief of debtors . . . [LaneScan] shall . . . (v) admit in writing its inability to pay its debts as they become due." According to the Plaintiffs, several statements meet this standard. Specifically, they cite the following statements, which they say constitute events of default under § 2.1(b)(v): (1) Seamons's statements to the Members in the March 28 Letter that LaneScan "has negative cash flow" and "has run out of cash";[250] (2) Seamons's statements to the Members in a letter sent April 6, 2006, which is largely duplicative of the March 28 Letter, that LaneScan "has negative cash flow" and "has run out of cash";[251] (3) the Defendants' statement in their Opening Brief in Support of Their Amended Motion to Dismiss and Motion to Stay Discovery that "it became clear that the Company was on the verge of running out of cash and ceasing its operations."[252]

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[250] JX 91 at DD00308- DD00309.
[251] JX 102 at JC000578- JC000579.
[252] Defs.' Opening Br. in Sup. of Their Am. Mot. to Dismiss & Mot. to Stay Discovery 9.

The Defendants argue that "LaneScan never actually reached the point of insolvency or 'inability to pay its debts as they become due' because the [M]erger infused LaneScan with capital before it reached that point."[253] According to the Defendants, none of the statements cited by the Plaintiffs actually meets the definition of an event of default under § 2.1(b)(v). Moreover, the Defendants argue, even if a technical event of default did occur, it was immediately cured by the Merger, and, therefore, the Plaintiffs have no remedy for the cured event of default.[254] Finally, the Defendants contend that, even if an uncured event of default occurred, the Plaintiffs may not, now, seek a remedy because they did not follow the procedure set forth in § 2.3 for obtaining a remedy. Under § 2.3, when a Note holder seeks immediate payment of his Note due to the occurrence of an event of default, he must submit a written notice to LaneScan declaring his Note immediately due and payable.

In response, the Plaintiffs argue that the Defendants have not submitted any proof that the event of default was cured. Furthermore, they contend that they were excused from providing notice to LaneScan pursuant to § 2.3 because LaneScan failed to provide them written notice of the event of default within five days after its occurrence, as required by § 2.2. Additionally, the Plaintiffs contend

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[253] Defs.' Post-Trial Br. 23 n.103.
[254] *See* Notes § 2.3 (stating that Note holders have certain remedies "[u]pon the occurrence of an Event of Default . . . (unless all Events of Default have been cured or waived by the [Note holders])").

that their court filings in this action asserting that an event of default occurred satisfy the requirements of § 2.3.[255]

The Court concludes that the statements cited by the Plaintiffs do not constitute an event of default. Under § 2.1(b)(v), an event of default occurred if LaneScan "admit[ted] in writing its inability to pay its debts as they become due." The statements cited by the Plaintiffs describe a state of affairs that precedes the point when LaneScan would have been unable to pay its debts as they become due. LaneScan entered into the Merger to avoid reaching this point. Apparently that point was near at the time of the Merger, but the Plaintiffs have not cited any writing in which LaneScan admitted that it had reached that point. This claim fails.

8. Remedy for the Notes Claims

The Court held above that the Defendants never had the authority to compel the Plaintiffs to contribute their Notes in connection with the Merger, and, therefore, the Plaintiffs are entitled to a declaratory judgment that their Notes have been valid, enforceable, and outstanding since the Notes' issuance to the Plaintiffs and remain valid, enforceable, and outstanding today. The Security Agreement, likewise, is and has been since its execution valid and enforceable.

[255] *See* Tr. (Post-Trial Oral Arg.) 9-10.

All of the claims upon which the Plaintiffs sought full payment of their Notes' principal and accrued interest failed. As a result, this remedy will not be ordered.

The Plaintiffs also ask this Court to place a constructive trust on LaneScan's assets because, they allege, the Defendants interfered with their ownership of the Notes, including the security interests granted under the Security Agreement.[256] As explained above, the Plaintiffs' Notes were not contributed and cancelled in connection with the Merger, and this Court has granted the Plaintiffs the declaratory judgment described above, which declares, in part, that the Security Agreement is valid and enforceable. Therefore, if the terms of the Security Agreement have been breached, the Plaintiffs may seek a legal remedy for that breach of contract.

Finally, the Plaintiffs claim that they are entitled to reimbursement of their attorneys' fees and expenses related to the Notes Claims. They argue that fee shifting is warranted under the terms of § 2.3 of the Notes and under the bad faith exception to the American Rule.

Section 2.3 of the Notes provides in pertinent part: "[LaneScan] shall pay all reasonable costs and expenses incurred by or on behalf of [a Note holder] in connection with [a Note holder's] exercise of any or all of its rights and remedies

[256] *See* Pls.' Pre-Trial Br. 19; Pls.' Opening Br. 31.

under this Note, including, without limitation, reasonable attorneys' fees." The Plaintiffs' argument for contractual fee shifting pursuant to § 2.3 is based upon the premise that "LaneScan breached the Notes and the remaining defendants converted and tortiously interfered with [the] Plaintiffs' rights in those Notes when they caused the Notes to be contributed and cancelled."[257] As discussed above, the Court has granted the Plaintiffs a declaratory judgment, but it has held that the Plaintiffs' Notes-related breach of contract, conversion, and tortious interference claims failed. Therefore, the Plaintiffs' argument for contractual fee shifting fails. Neither the Plaintiffs nor the Defendants advanced any arguments regarding whether contractual fee shifting would be triggered by a declaratory judgment, such as the one granted by the Court; thus, the Court reserves decision on this issue.

The Plaintiffs' argument that fee shifting should be granted under the bad faith exception to the American Rule fails. In support of this argument, the Plaintiffs cite *Venhill Limited Partnership v. Hillman*[258] for the proposition that a defendant is liable for the plaintiff's attorneys' fees when he has "caused the plaintiff to expend resources in the form of money and time in securing a clear right."[259] *Venhill* dealt with the bad faith exception to the American Rule. In that case the Court stated:

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[257] Pls.' Pre-Trial Br. 20; Pls.' Opening Br. 32.
[258] 2008 WL 2270488 (Del. Ch. June 3, 2008).
[259] *Id.* at *33.

> [T]he bad faith exception applies only in cases . . . of "unusually deplorable behavior"-pre-litigation behavior, so egregious that the defendant's proffer of a litigation defense is seen as in itself an act of bad faith, because the plaintiff's right to relief is so obvious and the defendant has unjustifiably caused the plaintiff to expend resources in the form of money and time in securing a clear right.[260]

Although the Court in *Venhill* found the defendant liable for multiple breaches of his fiduciary duties, it held that only one breach rose to the "unusually deplorable" level to justify fee shifting.[261] Simply put, the Defendants' actions—claiming that the Notes were contributed and cancelled when, in fact, they did not have the authority to compel their contribution—do not rise to the level of "unusually deplorable." This conclusion is buttressed by the fact that the Defendants' arguments that they did have such authority were far from frivolous, given that the LLC Agreement contained a broad Drag-Along Provision and that the line between LaneScan's equity (the Preferred Interests) and debt (the Notes) was somewhat blurry in terms of economic substance, if not legal form.

C. *Return of Capital Provision Claims*

As described and analyzed below, the Plaintiffs bring multiple claims against the Defendants related to the elimination of the Return of Capital Provision from the LLC Agreement by means of the Amendment.

[260] *Id.* (quoting *Barrows v. Bowen,* 1994 WL 514868, at *2 (Del.Ch. Sept.7, 1994)).
[261] *Id.*

1. Facts Surrounding the Amendment

As LaneScan's financial condition continued to deteriorate and other options for keeping it afloat proved unfeasible, it became increasingly apparent that the Merger was likely LaneScan's only shot at survival and, therefore, likely to occur. While recognizing that LaneScan was in dire financial straits and that no investor was likely to provide fresh capital in time to stave off insolvency, Detwiler opposed the Merger. Shortly before the Written Consent was distributed, Detwiler's attorney informed the attorney working for VSAC and LaneScan that, in his opinion, the Merger would trigger the Return of Capital Provision. The Board never formally discussed the Amendment before Seamons sent the March 28 Letter, to which the Written Consent was attached. A majority of the Board and holders of a majority of the Preferred Interests consented to the Amendment by executing the Written Consent. The most significant effect of the Amendment was the elimination of the Return of Capital Provision.

2. Breach of Contract

Although the Plaintiffs did not directly argue a standard breach of contract claim related to the Amendment,[262] there is some suggestion in their briefs that the

[262] According to the Plaintiffs, the Return of Capital Provision Claims are "legally premised upon two primary theories: (a) intentional misconduct under the LLC Agreement and (b) breach of the covenant of good faith and fair dealing." Pls.' Pre-Trial Br. 21.

Amendment breached the LLC Agreement. The Return of Capital Provision stated:

> *Notwithstanding anything to the contrary herein*, in the event of a Company Sale, prior to any payments by the buyer to the Company or any Member, as the case may be, the buyer shall, or shall cause the Company to, Distribute in cash to the holders of the Preferred Interests, prior and in preference to all other Members and the Company, as the case may be, an amount equal to the Unreturned Capital Contribution of such holders allocable to such Preferred Interests; provided, that in the event of a Company Sale contemplated by clause (a) of the definition of Company Sale such amount shall reduce the aggregate consideration that such holder would have received from any buyer in exchange for such Member's Preferred Interests. Any payments made hereunder shall be deemed a Distribution to such Members and each of their respective Capital Accounts shall be adjusted accordingly pursuant to Section 5.1(b).[263]

There is, perhaps, a suggestion in the Plaintiffs' arguments that the LLC Agreement was breached because the language "[n]otwithstanding anything to the contrary herein" expressly forbade the Amendment. The Amendment was effected pursuant to § 12.4 of the LLC Agreement, which states, in pertinent part:

> Except as otherwise provided in [the LLC] Agreement, [the LLC] Agreement and any provisions hereof may be amended and modified from time to time only by a written instrument adopted by a majority of the [Board.]

Neither the contractual language of § 12.4, on its face, nor the power § 12.4 grants to the Board is contrary to the Return of Capital Provision. Section 12.4 merely grants the Board the broad authority to amend the LLC Agreement; this

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[263] LLC Agreement at § 10.13 (initial emphasis added, latter emphasis in original).

power is not inconsistent with the Return of Capital Provision. The fact that the Board used this authority to eliminate the Return of Capital Provision, therefore, is not a breach of contract.

3. Breach of the Implied Covenant

The Plaintiffs also argue that the Defendants breached the implied covenant of good faith and fair dealing of the LLC Agreement in connection with the Amendment. The implied covenant attaches to every contract by operation of law,[264] and it cannot be eliminated from an LLC agreement.[265] It requires contracting parties "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."[266] Even where a contract creates completely discretionary rights, such rights must still be exercised in good faith.[267] The implied covenant also acts as a way to import terms into the agreement to analyze unanticipated developments or to fill gaps in the contract's provisions.[268] To state a claim for breach of the

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[264] *Gloucester Hldg. Corp. v. U.S. Tape & Sticky Prods., LLC*, 832 A.2d 116, 128 (Del. Ch. 2003).
[265] 6 *Del. C.* § 18-1101(c).
[266] *Dunlap v. State Farm Fire & Cas. Co.*, 878 A.2d 434, 442 (Del. 2005) (citation and internal quotation marks omitted).
[267] *Arvida/JMP P'rs, L.P. v. Vanderbilt Income & Growth Assoc., L.L.C.*, 1997 WL 294440, at *5 (Del. Ch. May 23, 1997).
[268] *Dunlap*, 878 A.2d at 442.

implied covenant, a litigant must allege a specific obligation implied in the contract, a breach of that obligation, and resulting damages.[269]

"The implied covenant of good faith and fair dealing involves a cautious enterprise."[270] "This quasi-reformation . . . should be a rare and fact-intensive exercise,"[271] and it should operate only "in that narrow band of cases where the contract as a whole speaks sufficiently to suggest an obligation and point to a result, but does not speak directly enough to provide an explicit answer."[272] Where the contract does speak directly regarding the issue in dispute, "[e]xisting contract terms control, . . . such that implied good faith cannot be used to circumvent the parties' bargain, or to create a free-floating duty unattached to the underlying legal documents."[273] Generally, a claim for breach of the implied covenant may not be based on conduct authorized by the terms of the agreement.[274]

First, the Plaintiffs seek to apply the implied covenant as a gap-filler. They argue that "[t]he language of the LLC Agreement does not address whether as part of a Company Sale the members could eliminate a contractual protection intended to specifically apply to such sale."[275] They contend that the implied covenant filled this gap by preventing the Board from removing the Return of Capital Provision in

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[269] *Fitzgerald v. Cantor*, 1998 WL 842316, at *1 (Del. Ch. Nov. 10, 1998).
[270] *Nemec v. Shrader*, 991 A.2d 1120, 1125 (Del. 2010) (internal quotation and citations omitted).
[271] *Dunlap*, 878 A.2d at 442.
[272] *Lonergan v. EPE Hldgs. LLC*, 5 A.3d 1008, 1018 (Del. Ch. 2010).
[273] *Dunlap*, 878 A.2d at 441 (citation and internal quotation marks omitted).
[274] *Id.*
[275] Pls.' Pre-Trial Br. 26; Pls.' Opening Br. 40-41.

connection with a sale of LaneScan. According to the Plaintiffs, this is a logical conclusion because allowing the Amendment "would mean that [the Return of Capital Provision] was an illusory provision of the LLC Agreement."[276]

This argument fails. Section 12.4 granted the Board a broad power pursuant to which it could amend or modify any provision of the LLC Agreement, "except as otherwise provided in [the LLC Agreement]."[277] The second paragraph of § 12.4 provided an illustrative list of amendments and modifications the Board might make, but nothing in § 12.4 generally limits the broad power it grants the Board.[278] When the Board is granted a broad power such as this, a plaintiff may not simply argue that some specific use of this power was not countenanced merely because it is not recited in the LLC agreement. For "[t]he language of the LLC Agreement [to] address" every possible way and situation in which the Board might amend or modify the LLC Agreement would result in documents that are absurdly long and convoluted. In short, the Plaintiffs have not shown that there was any gap to fill. This conclusion finds further support in the one restriction that applied to the Board's broad power to amend or modify the LLC Agreement: that it could not do so to provisions that provided as such. This shows that the parties to the LLC Agreement did contemplate creating provisions that could not be

[276] Pls.' Pre-Trial Br. 26; Pls.' Opening Br. 41.
[277] LLC Agreement at § 12.4.
[278] *See id.*

amended or modified. Apparently, they did not decide to make the Return of Capital Provision one of these provisions.

Second, the Plaintiffs argue that the Amendment was a bad faith violation of the implied covenant. This argument also fails. The Plaintiffs approach offering nothing more than general allegations of bad faith. They question the independence and disinterestedness of the Board that approved the Amendment and the process by which the Amendment was considered and approved. Such problems, if true, might illuminate the motivations for taking a bad faith action or uncover how it was taken, but they do not directly speak to a bad faith action itself. The Plaintiffs do allege that "the Amendment was intended to deprive [the P]laintiffs and other non-consenting [M]embers of their Capital-Repayment rights specifically in connection with the Merger, which constituted a Company Sale" (the "punishment argument").[279] Also, although they do not state this clearly in connection with their implied covenant argument, the apparent purpose of the Amendment, in the Plaintiffs' view, was to enrich Pittco and Starnes, the largest owners of VSAC preferred interests, at the expense LaneScan's other Members.

The Plaintiffs' bad faith violation of the implied covenant argument has a high hurdle to clear because, as explained above, the Amendment was authorized by the § 12.4. Generally, the punishment argument does not work because the

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[279] Pls.' Pre-Trial Br. 26; Pls.' Opening Br. 41.

Amendment eliminated the return of capital rights for all Preferred Members, not just those who did not consent to the Merger. Specifically, MKESF and MKEIF lost their return of capital rights and were diluted by the Merger to the same extent as the Plaintiffs, and, yet, their Board designee, Grayson, consented to the Amendment. Grayson's vote is by no means dispositive of this issue, but it illustrates the weakness of the punishment argument. Ultimately, the Plaintiffs' bad faith argument fails because the Court finds that a majority of the directors consented to the Amendment so that the Merger could occur. Without the Amendment, VSAC would not have merged with LaneScan,[280] and, without the Merger, LaneScan would have soon become insolvent.[281] LaneScan had little liquidation value;[282] therefore, the Merger was LaneScan's only chance to salvage some value for its owners.[283] In light of the facts that the Amendment was authorized by the LLC Agreement and that the Director Defendants' overriding motivation with regard to the Amendment and the Merger was to preserve whatever value they could from LaneScan, the Plaintiffs' broad bad faith allegations, supported largely by general fiduciary duty arguments, fail.

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[280] Tr. 148, 167. *See also* Van Wormer Dep. 252-53.
[281] Tr. 141, 144, 149, 151, 223-26.
[282] *Id.* at 124-25, 245-46.
[283] *Id.* at 141, 149, 151, 225-26.

4. Intentional Misconduct

The Plaintiffs' Return of Capital Provision intentional misconduct claims fail, as explained *infra* Part V.D.

D. *Intentional Misconduct and Gross Negligence Claims*

The Plaintiffs assert fiduciary duty and breach of contract claims under § 7.1 of the LLC Agreement against the Director Defendants and Investor Defendants, in their capacities as directors and Preferred Members, for alleged intentional misconduct and gross negligence.[284] The intentional misconduct claims relate to Director Defendants' and Investor Defendants' consent to the Merger, including the terms by which the Preferred Members were purportedly compelled to contribute their Notes, and their consent to the Amendment. The gross negligence claim relates to the process by which the Merger was approved.

1. Did the Director Defendants and Investor Defendants have Contractual Duties or Fiduciary Duties to Abstain from Intentional Misconduct and Gross Negligence?

The parties disagree concerning whether the Director Defendants and Investor Defendants had any contractual or fiduciary duties to abstain from intentional misconduct and gross negligence. The Plaintiffs argue that the Director

[284] The Plaintiffs also assert a separate fiduciary duty claim against Van Wormer, in his capacity as an officer, under § 4.6(c) of the LLC Agreement, which is addressed by the Court below. *See infra* Part V.E.

Defendants and Investor Defendants did have such duties under § 7.1 of the LLC Agreement. Section 7.1 states, in pertinent part:

> No Member, Director or Officer shall have any duty to any Member or the Company, except as expressly set forth herein or in other written Contracts. Except as expressly set forth herein or in any other written Contract, no Member, Director or Officer of the Company shall be liable to the Company or to any Member for any loss or damage sustained by the Company or any Member, unless the loss or damage shall have been the result of gross negligence, fraud or intentional misconduct of such Member, Director or Officer, or in the case of an Officer, breach of such Person's duties pursuant to Section 4.6.

According to the Plaintiffs, the plain language of § 7.1 established that the Director Defendants and Investor Defendants, as directors and Members, had duties to abstain from acts of intentional misconduct and gross negligence that harmed LaneScan or its Members.

The Defendants correctly note that an LLC agreement may limit or eliminate any and all liability for breaches of fiduciary duties, although it may not eliminate liability for breaches of the implied covenant.[285] Indeed, "parties to [an LLC] agreement can contractually expand, restrict, modify, or fully eliminate the fiduciary duties owed by the company or its members, subject to certain

[285] 6 *Del. C.* § 18-1101(e).

limitations."[286] According to the Defendants, § 7.1 eliminated all of their fiduciary duties. In support of this argument, they cite *Fisk Ventures, LLC v. Segal*.[287]

Fisk Ventures involved contractual duty claims and fiduciary duty claims against two members of Genitrix LLC ("Genitrix"). The portion of Genitrix's LLC agreement addressing the limitation of fiduciary duties ("Genitrix LLC Agreement § 9.1") is almost identical to the quoted potion of § 7.1, as illustrated below:[288]

LaneScan LLC Agreement § 7.1	**Genitrix LLC Agreement § 9.1**
"No Member, Director or Officer shall have any duty to any Member or the Company, except as expressly set forth herein or in other written Contracts. Except as expressly set forth herein or in any other written Contract, no Member, Director or Officer of the Company shall be liable to the Company or to any Member for any loss or damage sustained by the Company or any Member, unless the loss or damage shall have been the result of gross negligence, fraud or intentional misconduct of such Member, Director or Officer, or in the case of an Officer, breach of such Person's duties pursuant to Section 4.6."	"No Member shall have any duty to any Member of the Company except as expressly set forth herein or in other written agreements. No Member, Representative, or Officer of the Company shall be liable to the Company or to any Member, unless the loss or damage shall have been the result of gross negligence, fraud or intentional misconduct by the Member, Representative or Officer in question . . ."

[286] *In re Atlas Energy Res., LLC, Unitholder Litig.*, 2010 WL 4273122, at *6 (Del. Ch. Oct. 28, 2010) (citing 6 *Del. C.* § 18-1101(e)).
[287] 2008 WL 1961156 (Del. Ch. May 7, 2008).
[288] *Compare* LLC Agreement at § 7.1, *with Fisk Ventures*, 2008 WL 1961156, at *9 (quoting relevant LLC agreement provision). *See also* Defs.' Pre-Trial Br. 35.

The most significant difference between these two provisions is that the first sentence of § 7.1 of the LLC Agreement covers directors, officers, and Members, while the analogous sentence in Genitrix LLC Agreement § 9.1 only applied to members. In *Fisk Ventures*, with respect to members, the Court concluded that Genitrix LLC Agreement § 9.1 eliminated all fiduciary duties and did not create any fiduciary duties or contractual duties.[289] The Court concluded that the first sentence of Genitrix LLC Agreement § 9.1 "eliminate[d] fiduciary duties to the maximum extent permitted by law by flatly stating that members have no duties other than those expressly articulated in the [a]greement."[290] The Court concluded that the second sentence of Genitrix LLC Agreement § 9.1 did not create any duties. The Court stated: "Because the [a]greement does not expressly articulate fiduciary duties, they are eliminated."[291] This same logic applied to the plaintiff's argument that Genitrix LLC Agreement § 9.1 established contractual duties.[292]

[289] *Fisk Ventures*, 2008 WL 1961156, at *9-11.
[290] *Id.* at *11.
[291] *Id.*
[292] *See id.* at *9 (rejecting the plaintiff's argument that Genitrix LLC Agreement § 9.1 "establishe[d] a [contractual] duty to act without gross negligence, fraud, or intentional misconduct"). Although the plaintiff in Fisk Ventures apparently argued in support of a very broad set of contractual duties that he termed a "code of conduct," the Court appears to have rejected the notion that Genitrix LLC Agreement § 9.1 created any contractual duties analogous to fiduciary duties. *See id.*; *id.* at 11 (explaining that the plaintiff's fiduciary duty claims were merely his contractual duty claims "dresse[d] . . . in fiduciary duties' clothing").

Indeed, the Court read Genitrix LLC Agreement § 9.1 as "an expressly exculpatory provision" that "expressly claim[ed] to limit or waive liability," not create it.[293]

The Plaintiffs argue that *Fisk Ventures* is not controlling for various reasons. First, they attempt to distinguish it factually from the instant case, correctly noting that *Fisk Ventures* involved an unusual power-sharing arrangement between the two primary classes of members, whereby each of these two classes had, essentially, veto power.[294] The Plaintiffs are correct that this factual quirk is not present in the instant case and that the Court in *Fisk Ventures* disapproved of the plaintiff's attempts to circumvent this veto power by asserting contractual duty claims and fiduciary duty claims against certain members.[295] But, the contractual analysis in *Fisk Ventures* turned on the language of Genitrix's LLC agreement, not these particular facts.[296] Second, the Plaintiffs' point out that the Court in *Fisk Ventures* explained that, even if there were contractual duties or fiduciary duties to act without gross negligence or intentional misconduct, the Plaintiffs still failed to adequately plead such claims.[297] This is true; however, that fact did not change the Court's conclusion regarding Genitrix LLC Agreement § 9.1. Third, the Plaintiffs contend that the second sentence of § 7.1 must establish duties, otherwise it would

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[293] *Id.* at *9.
[294] *Id.* at *1.
[295] *See id.* at *8-9.
[296] For this same reason, what the Plaintiffs' refer to as their third and fourth arguments in their Pre-Trial Brief also fail. They, too, are based on purported factual distinctions. *See* Pls.' Pre-Trial Br. 29-30.
[297] *Fisk Ventures*, 2008 WL 1961156, at *9, *11.

be surplusage. This is the Plaintiffs strongest argument, but, following *Fisk Ventures*, the Court concludes that it fails.

The Court in *Fisk Ventures* stated that "[b]ecause the [a]greement *does not expressly articulate fiduciary duties*, they are eliminated."[298] Furthermore, it rejected the notion that Genitrix LLC Agreement § 9.1 created contractual duties.[299] The Court in *Fisk Ventures* read Genitrix LLC Agreement § 9.1 as a provision that sought only to eliminate duties and limit any potential liability; it did not interpret this provision as attempting, in any sense, to create any duties or any potential liability. Following this line of thought, § 7.1 may be interpreted as such: (1) the first sentence "eliminate[d] fiduciary duties to the maximum extent permitted by law by flatly stating that [M]embers [and directors] have no duties other than those expressly articulated in the [a]greement";[300] and (2) in an abundance of caution, the second sentence states that, if any duties are ever found in any agreement, unless such agreement expressly states otherwise, the directors, officers, and Members can only be liable as a result of those duties if the damage suffered was a result of gross negligence, fraud, or intentional misconduct. In essence, the second sentence is a "just in case" measure meant to ensure that any

[298] *Id.* at *11.
[299] *See id.* at *9.
[300] *Id.* at *11.

duty established (inadvertently or otherwise) is limited (at least in terms of liability) to gross negligence, fraud, and intentional misconduct.

As in *Fisk Ventures*, in the end, it does not matter whether LaneScan's fiduciaries were subject to the contractual duties or fiduciary duties asserted by the Plaintiffs because, even if they were, they would not be found liable. If the Director Defendants[301] had any fiduciary duties or similar duties arising under contract, such duties were limited to duties to refrain from acts of gross negligence, fraud, or intentional misconduct, because any such duties must be measured by reference to the language of the second sentence of § 7.1. In other words, the LLC Agreement retained or established, if any duties, only the duty of due care[302] and a small sliver of the duty of loyalty (the duty to refrain from intentional misconduct).[303]

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[301] The Plaintiffs bring contractual duty and fiduciary duty claims against the Investor Defendants, in their capacities as Members, in addition to the Director Defendants. Because fiduciary duties are most easily understood in the context of directors when, as in the instant case, there is no controller or control group, the Court will analyze the Plaintiffs' contractual duty and fiduciary duty claims with respect to the Director Defendants. If it were found that § 7.1 did establish duties, including duties for non-controlling Members, the Investor Defendants would still not be liable for the same reasons that the Director Defendants would not be liable, which are explained below.

[302] *See Albert v. Alex. Brown Mgmt. Servs., Inc.*, 2005 WL 2130607, at *8 (Del. Ch. Aug. 26, 2005) (equating gross negligence with the duty of care).

[303] The duty to refrain from intentional misconduct is a subset of the general duty of loyalty, much akin to, and essentially a subset of or another name for, the duty to act in good faith, where the focus is on whether the defendant (1) acted intentionally to harm those to whom he owes the duty or (2) intentionally or consciously ignored his duties, thereby causing harm to those to whom he owes the duty to refrain from intentional misconduct. *See In re The Walt Disney Co. Deriv. Litig.*, 825 A.2d 275, 290 (Del. Ch. 2003); *McMillan v. Intercargo Corp.*, 768 A.2d 492,

Finally, the Plaintiffs assert both breach of contract and breach of fiduciary duty claims related to the Director Defendants' alleged gross negligence and intentional misconduct. Generally, there appears to be some confusion regarding whether breaches of the duties retained or established in an LLC agreement form the basis of contract claims (in which case the duties are often referred to as "contractual duties" or "contractual fiduciary duties") or more typical fiduciary duty claims. Here, the Plaintiffs have asserted claims under both theories.[304] The Court concludes that, in this instance, the applicable standard to be applied is the same under either theory.[305] Therefore, the Court will analyze these two claims together (referring to them, generally, as "fiduciary duty claims" based upon breaches of "fiduciary duties"), and it need not decide if one theory is the "proper" theory of recovery or if both theories are legally cognizable.

2. Gross Negligence

The Plaintiffs assert a gross negligence claim against the Director Defendants based on their actions in considering and approving the Merger.[306] The

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501 n.41 (Del. Ch. 2000); *Blackmore P'rs, L.P. v. Link Energy LLC*, 864 A.2d 80, 86 (Del. Ch. 2004); *O'Reilly v. Transworld Healthcare, Inc.*, 745 A.2d 902, 914-15 (Del. Ch. 1999).

[304] *See* Pls.' Opening Br. 33-43.

[305] The underlying doctrinal question—not all that important—can typically be resolved through a close reading of the contractual text.

[306] *See* Pls.' Opening Br. 41-42. As with many of the Plaintiffs' claims, it is difficult to ascertain, specifically, which of the Defendants this claim is being brought against. This is due to the Plaintiffs' practice of using the general term "Defendants" throughout their briefs, and even pivoting back to the term "Defendants" after specifically identifying a certain Defendant or group of Defendants against whom a claim is being brought. Throughout this Memorandum

Defendants argue that no gross negligence claim was fairly presented for trial.[307] The Court agrees, and the Plaintiffs' gross negligence claim fails for this reason.

The Court reaches this conclusion after reviewing the relevant court filings that preceded the trial to ascertain whether a gross negligence claim was fairly presented for trial. Obviously, the documents most relevant to this inquiry are the Pre-Trial Stipulation and the Plaintiffs' Pre-Trial Brief, but the Court will look back even further to see if anything in the Amended Complaint could have given the Defendants notice that a gross negligence claim was being brought against the Director Defendants in their capacity as directors, pursuant to § 7.1.

The Amended Complaint gave no indication that the Plaintiffs sought to bring a gross negligence claim against the Director Defendants, in their capacity as directors, pursuant to § 7.1. The phrase "gross negligence" was not used in the Amended Complaint.[308] Count I of the Amended Complaint was a claim for intentional misconduct.[309] Count I did not refer to either gross negligence or the duty of care; in fact, the factual allegations contained in Count I focused almost exclusively on duty of loyalty issues, particularly those related to: (1) the directors'

Opinion, the Court has considered the Plaintiffs' claims to have been brought against the widest possible population of Defendants.

[307] *See* Defs.' Post-Trial Br. 21. When addressing the Plaintiffs' intentional misconduct and gross negligence claims in their Post-Trial Brief, the Defendants argued that "[the] Plaintiffs assert their first count [in the Pre-Trial Stipulation] as *solely* a claim for intentional misconduct in breach of the LLC Agreement." *Id.* (emphasis added). No other arguments were presented against the gross negligence claims.

[308] *See* Compl.

[309] *Id.* at 22-23.

interestedness and independence; (2) the self-dealing aspects of the Merger; and (3) factors the Court might consider in an entire fairness analysis.[310] The phrase "due care" was only mentioned in Count VIII, a fiduciary duty claim—including a duty of care claim—against Van Wormer, *in his capacity as an officer, pursuant to § 4.6(c)* of the LLC Agreement, which the Defendants have argued assigned *broader duties* to officers than those assigned to other fiduciaries under § 7.1.[311] The gross negligence claim brought against Van Wormer, in his capacity as an officer, pursuant to § 4.6(c), further supports the Court's conclusion that the gross negligence claim was not fairly presented for trial. It reveals that the Plaintiffs knew how to clearly and unambiguously set forth a due care claim;[312] therefore, there is even less reason to suspect that a due care claim against the Director Defendants, in their capacity as directors, pursuant to § 7.1, was quietly lurking in the Amended Complaint shrouded in ambiguous language.

The next relevant document is the Plaintiffs' Pre-Trial Brief. It did not mention the phrase "due care" and only mentioned the phrase "gross negligence" in two contexts. The first was when the Plaintiffs were quoting the LLC Agreement, specifically § 7.1, or otherwise arguing that an intentional-misconduct-related duty existed, which entailed quoting § 7.1 and similar provisions from other

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[310] *See id.*
[311] *Id.* at 28.
[312] *See id.* ("In derogation of his duties of loyalty and due care . . .").

cases.[313] The second context in which gross negligence was mentioned is the closest the Plaintiffs came to raising fairly, for trial, the issue of a gross negligence claim against the Director Defendants, in their capacity as directors, pursuant to § 7.1. But, it still falls far short of the mark. While arguing that § 7.1 did, indeed, set forth an intentional-misconduct-related duty, the Plaintiffs stated the following:

> Under Delaware law, the hierarchy of mental states (in order of lesser to higher) are negligence, gross negligence, recklessness, intent, and malice. Recently, the Supreme Court of Delaware held that by definition a finding of an intentional breach of a duty subsumes a grossly negligent breach of that duty. Therefore, if the Court finds defendants intentionally breached their duties to plaintiffs, then defendants shall be liable to plaintiffs for any loss or damages sustained by plaintiffs because an intentional breach of duty would, by definition, include a gross negligent breach of duty and fall within Section 7.1 of the LLC agreement.[314]

This argument essentially boils down to a statement that, if intentional misconduct is proven, liability may be found, not only on the basis of intentional misconduct, but also because intentional conduct subsumes gross negligence. Nowhere in their Pre-Trial Brief do the Plaintiffs state that they are bringing a separate claim against the Director Defendants, in their capacity as directors, pursuant to § 7.1, on the basis of gross negligence or that they will prove gross negligence at trial. Moreover, shortly before the quote above, while arguing that this action is distinguishable from *Fisk Ventures*, the Plaintiffs tout the LLC Agreement's

[313] Pls.' Pre-Trial Br. 21, 28, 30.
[314] *Id.* at 31 (internal quotations and citations omitted).

"primarily scienter-based standard of loyalty."[315] As a result, the Plaintiffs argued, *Fisk Ventures* is not persuasive authority because, they claimed, they could prove intentional misconduct in the instant case.[316] Therefore, not only did the Plaintiffs not fairly present a gross negligence claim, they affirmatively distanced themselves from such a claim as part of their argument that the Court should recognize their intentional misconduct claim.[317]

In their Pre-Trial Brief, the Plaintiffs also discussed actions relevant to a due care inquiry in connection with their argument that Van Wormer, in his capacity as an officer, breached his fiduciary duties.[318]

Lastly, perhaps the most relevant document to this inquiry, and the last one filed, is the Pre-Trial Stipulation. The phrase "due care" was not present in the Pre-Trial Stipulation. In the Pre-Trial Stipulation, Count I was a claim for intentional misconduct; neither gross negligence nor due care were mentioned in connection with Count I.[319] The only claim that encompasses gross negligence or due care was Count VIII, which was a fiduciary duty claim against Van Wormer, in his capacity as an officer. In the "Plaintiffs' Statement of Legal Issues That

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[315] *Id.* at 29.
[316] *Id.*
[317] In *Fisk Ventures*, this Court concluded that an LLC agreement provision almost identical to § 7.1 eliminated all duties. The Plaintiffs' arguments referenced above were part of their larger argument that the Court should not follow *Fisk Ventures* because the present case is distinguishable. Apparently, the Plaintiffs viewed an emphasis on the intentional misconduct portion of their case as beneficial to this argument.
[318] *Id.*
[319] Pre-Trial Stipulation 2.

Remain to be Litigated" there was no mention of gross negligence;[320] intentional misconduct was mentioned three times.[321]

In general, the Plaintiffs' claims were not well-defined, and it was difficult to understand precisely which parties they were being asserted against, due to the Plaintiffs' frequent lack of specificity and overuse of the term "Defendants." The fiduciary duty claim against Van Wormer, in his capacity as an officer, was, perhaps, the most well-defined and precisely targeted claim of any. It was clear that the gross negligence portion of this claim was not being asserted against the other Defendants, or even against Van Wormer in his capacity as a director and a Preferred Member. The Court and—it is clear from their briefs—the Defendants viewed the other fiduciary-duty-related claim as a charge that the Director Defendants committed intentional misconduct. The Defendants did not present any arguments in opposition to the broader gross negligence claim.[322] As the Plaintiffs themselves recognized, intentional misconduct involves a different mental state than gross negligence.[323] A claim of intentional misconduct is easier to defeat, and one's trial strategy for defending against an intentional misconduct

[320] *Id.* at ¶¶ 140-53. Again, only the fiduciary duty claim against Van Wormer, in his capacity as an officer, could be seen to touch on this issue. *Id.* at ¶ 153.
[321] *Id.* at ¶¶ 140, 142, 144.
[322] *See* Defs.' Post-Trial Br. 21; *see also* Defs.' Pre-Trial Br. 33-37 (discussing due care and gross negligence only in the contexts of the claim against Van Wormer or when discussing whether § 7.1 eliminated all fiduciary duties); Tr. (Post-Trial Oral Arg.) 42-43 (only discussing gross negligence in response to the Court's questions).
[323] Pls.' Pre-Trial Br. 31; Pls.' Reply Br. 23.

claim might differ substantially from the strategy followed to defend against a gross negligence claim.

The Court also recognizes that the Plaintiffs may contend that the issue of the Defendants' alleged gross negligence was tried by implied consent and, therefore, may be treated, under Court of Chancery Rule 15(b), as if it had been raised in the pleadings. Without now ruling on any such argument, the Court simply notes that, as this case was being tried, the Court did not fully appreciate that the Plaintiffs were bringing an independent claim for gross negligence.

In sum, the Court concludes that the Plaintiffs' gross negligence claim against the Director Defendants and Investor Defendants, in their capacities as directors and Preferred Members, pursuant to § 7.1, was not fairly presented for trial.

3. Intentional Misconduct

The Plaintiffs allege that the Director Defendants engaged in intentional misconduct. The intentional misconduct claims relate to the Director Defendants' approval of the Merger, including the terms by which the Preferred Members were purportedly compelled to contribute their Notes, and their consent to the Amendment.

Although the Plaintiffs must prove *intentional misconduct* before they could succeed on these claims, most of their arguments focused on general loyalty and

due care concerns.[324] Indeed, it appears that the Plaintiffs want to turn their intentional misconduct claim into a general loyalty claim in which they prove that the Merger was a self-dealing transaction, approved by a conflicted board, and, therefore, is assessed under the entire fairness standard.[325] They even use a clever, subtextual argument to make it seem that, by prevailing on a self-dealing/entire fairness claim, they must have also proven, or at least gone a far way toward proving, intentional misconduct.[326] To be clear, the Plaintiffs never explicitly state this conclusion, but it is the conclusion one seemingly is left to draw from their statement that "[a]ssuming *arguendo* that intentional misconduct requires a showing of self-interest under fiduciary duty principles, the evidence shows that the transaction was not approved by a majority of disinterested and independent directors."[327]

As the Plaintiffs recognized with the qualifier "assuming *arguendo*," a claim for intentional misconduct does not require that the plaintiff make out a general loyalty claim. More importantly, as this Court has previously recognized, proving

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[324] Pls.' Pre-Trial Br. 22-23; Pls.' Opening Br. 35-41; Pls.' Reply Br. 24-25.
[325] *See* Pls.' Opening Br. 35-41 (addressing the disinterestedness and independence (or lack thereof) of each director and the alleged shortcomings of the Board's processes for considering the Merger, the Amendment, and the exchange ratio); Pls.' Reply Br. 24-25 ("Defendants' . . . intentional misconduct [is] shown by their failure to employ any of the traditional processes used for dealing with conflicted director transactions. . . . Such lack of any procedural safeguards in the face of the direct financial conflicts faced by the Defendants demonstrates . . . intentional misconduct.").
[326] *See* Pls.' Pre-Trial Br. 22.
[327] *Id.* (citations omitted).

a self-dealing/entire fairness claim is *not necessarily sufficient* to prove an intentional misconduct claim.[328] As explained in *Venhill*, this is because:

> under the traditional operation of the entire fairness standard, the self-dealing director would have breached his duty of loyalty if the transaction was unfair, regardless of whether he acted in subjective good faith. After all, that is the central insight of the entire fairness test, which is when a fiduciary self-deals he might unfairly advantage himself even if he is subjectively attempting to avoid doing so.[329]

On the other hand, an intentional misconduct claim or bad faith claim "require[s] an examination of [the defendants'] state of mind, in order to determine whether they breached their duty of loyalty by [committing an act] in bad faith [or intentional misconduct] . . . rather than in good faith [or without an intention to harm the company.]"[330] Thus, when intentional misconduct or bad faith is the standard at issue, and not the general, broader loyalty standard, some showing of the requisite mental state is necessary for the defendant to be liable; mere

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[328] *Guttman v. Huang*, 823 A.2d 492, 506 (Del. Ch. 2003) ("There might be situations where a director acts in subjective good faith and is yet not loyal (*e.g.*, if the director is interested in a transaction subject to the entire fairness standard and cannot prove financial fairness), but there is no case in which a director can act in subjective bad faith towards the corporation and act loyally."). *See also Venhill*, 2008 WL 2270488, at *22-23. The duties to refrain from actions taken in bad faith and intentional misconduct are closely linked and analogous for purposes of understanding how their standards compare to the general self-dealing/entire fairness standard. *See supra* Part V.D.1 (explaining the intentional misconduct standard and its ties to the duty to act in good faith).

[329] *Venhill*, 2008 WL 2270488, at *22.

[330] *Id.* at *23 (referring to the liability of conflicted, but not self-dealing directors, who vote in favor of a self-dealing transaction, and whose liability, therefore, is premised on a finding that they acted in bad faith). *See also Guttman*, 823 A.2d, at 506 (explaining that *In re Caremark Int'l Deriv. Litig.*, 698 A.2d 959 (Del. Ch. 1996), as a bad faith case, "premise[d] liability on a showing that the directors were *conscious* of the fact that they were not doing their jobs" (emphasis added)).

participation in a self-dealing, unfair transaction is not enough, without a showing of the requisite mental state.[331] Of course, it will often be "useful" for the Court to apply an entire fairness analysis in such a case, but it is not the test by which liability is established under an intentional misconduct standard.[332] Entire fairness as an independent conceptual basis for liability is largely precluded here by the LLC Agreement's elimination of general fiduciary duties. Moreover, the Court is satisfied that the Defendants undertook the challenged actions in an attempt to salvage whatever value remained in LaneScan, not in an attempt to harm the Plaintiffs.

Surely general loyalty and due care concerns are not irrelevant to an intentional misconduct analysis. A self-interested or otherwise conflicted director has an incentive to engage in certain sorts of intentional misconduct that an independent director would not. Indeed, one reason why the intentional misconduct and bad faith standards are so exceedingly hard to meet is that such claims are often a last resort when there is no general loyalty claim. Due care factors are also not to be ignored when assessing potential intentional misconduct. A loose, sloppy deal process that strays far from what is standard and expected of

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[331] *See Venhill*, 2008 WL 2270488, at *24 (concluding that a limited partnership agreement provision that limited fiduciary duty liability in a manner substantially similar to § 7.1 of the LLC Agreement "insulate[d] [the defendant] from liability if his [self-dealing transactions] were unfair . . . but well-intentioned[.]").

[332] *See id.* (stating that, in establishing liability in that case, it was "useful" to apply the entire fairness standard because it "surface[d] [the defendant's] disregard for the best interests [of the plaintiff]").

an informed, well-functioning board may be indicative of an act of intentional misconduct that a faithless fiduciary is trying to ram through before more loyal directors wise up. Financial and legal experts may not be consulted when it is clear they would ring an alarm bell concerning contemplated intentional misconduct, a shocking sweetheart deal or patently illegal actions, for example.

Nevertheless, intentional misconduct remains a difficult standard to meet, even when the disinterestedness and independence of the Board is in question and the deal process falls significantly short of best practices. The standard remains difficult because, all other issues aside, *intentional misconduct* must be proven. This requires a showing that the fiduciary intentionally harmed those to whom the duty is owed.

For purposes of this analysis, the Court will assume that a majority of the directors who voted on the Merger, including the purported Compelled Contribution, and the Amendment were conflicted. Moreover, the Court acknowledges that deal process did, indeed, fall far short of best practices. It was characterized by a troubling degree of informality. No formal Board meetings took place during the time the Merger was being considered,[333] although there were monthly phone calls among the directors during that time.[334] Details of the Amendment's origins are hazy, but it is clear that it was not seriously discussed by

[333] Van Wormer Dep. 97.
[334] Tr. 116, 133.

the entire Board before being adopted by the Written Consent.[335] LaneScan did have a legal advisor, although apparently the same firm was advising VSAC.[336] Also, LaneScan received a fairness opinion, but, again, this financial advisor was simultaneously working for VSAC.[337] No traditional bargaining was performed on behalf of LaneScan by anyone whose disinterestedness and independence could not be questioned.[338] In fact, the exchange ratio was set by Southard Financial in the Opinion.[339] While this strikes the Court as atypical, given LaneScan's incredibly weak bargaining position and the high degree of overlapping interests between LaneScan and VSAC, there is perhaps some logic to this arrangement. Without it, VSAC would have faced a scenario where either it bargained hard and risked looking like it was using its insider position to get an unfair price, or it did not bargain hard and risked paying too much. In the end, the only "bargaining" to speak of was Seamons's objection to the first exchange ratio, which led to a slightly better ratio for LaneScan's Members.[340] Overall, the entire process seemed to have been driven by Seamons, who was the chairman of LaneScan's Board and VSAC's board, and was employed by the largest equity owner of each company.

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[335] Van Wormer Dep. 248-52; Seamons Dep. 36.
[336] *Supra* Part III.G. n.192.
[337] JX 46.
[338] Tr. 161.
[339] JX 93.
[340] *Compare* JX 72 at PIT000262, *with* JX 93 at PIT000402.

None of these shortcomings is direct proof of intentional misconduct, however. The actual intentional misconduct, according to the Plaintiffs, was the Director Defendants' participation in a self-dealing transaction designed to benefit those Members who also owned equity stakes in VSAC at the expense of the other Members.[341] Two specific aspects of the Director Defendants' allegedly wrongful Merger plot were the Amendment and the purported Compelled Contribution. These specific acts of alleged intentional misconduct made LaneScan more valuable to VSAC, and, thus, furthered the Director Defendants' wrongful goal of enriching VSAC at the expense of the Members.[342]

This claim fails. Beyond setting forth in general terms what they believe the intentional misconduct was, the Plaintiffs do very little to flesh out their theory of intentional misconduct. Indeed, they rely almost exclusively on their general loyalty and due care concerns, to the point of practically admitting that these allegations, alone, constitute the only grounds for their intentional misconduct

[341] There is, perhaps, some suggestion that the Defendants' alleged breaches of the LLC Agreement in connection with the Amendment and the purported Compelled Contribution also constituted intentional misconduct. To the extent that an intentional misconduct claim based upon these allegations was asserted, that claim fails, since the Court has concluded that these actions did not breach the LLC Agreement.

[342] The Plaintiffs have possibly argued that the Amendment and purported Compelled Contribution were undertaken to spite the Plaintiffs and other dissenting Preferred Members. To the extent this is the basis of an intentional misconduct claim, it fails because the Court finds no evidence that these actions were taken in spite or to punish any of the Preferred Members.

claim.[343] They make conclusory allegations that the price received by LaneScan was insufficient and complain that LaneScan's management and Board did not try hard enough to cut costs and raise new capital.

Although the Plaintiffs might have done things differently, the record demonstrates that LaneScan did engage in cost-cutting and sought new capital from various sources. LaneScan's cost-cutting measures were not enough to make up for the fact that it was chronically under-projection in terms of sales. Unsurprisingly, investors were not flocking to invest in a failing company whose current investors refused to sink more of their own funds into it. Despite the informality surrounding the Board's communications, the Board was aware of the impending liquidity crisis and the general point at which LaneScan would reach insolvency. Detwiler, who himself opposed the Merger, even recognized that LaneScan would run out of funds before new capital could be raised. The record also demonstrates that LaneScan had little liquidation value, and the Preferred Members would likely have received nothing if it filed for bankruptcy or was otherwise liquidated.

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[343] *See* Pls.' Reply Br. 24-25 ("Defendants' gross negligence and intentional misconduct are shown by their failure to employ any of the traditional processes used for dealing with conflicted director transactions. . . . Such lack of procedural safeguards in the face of direct financial conflicts faced by the Defendants demonstrates both gross negligence and intentional misconduct."). *See also id.* at 23 (arguing that the Defendants incorrectly contend that the Plaintiffs must demonstrate bad faith to succeed on their intentional misconduct claims).

The Court finds that the Director Defendants' overriding motivation with regard to the Merger, in general, and the Amendment and purported Compelled Contribution, specifically, was to salvage whatever value they could from LaneScan. Without the Amendment[344] and the Compelled Contribution,[345] VSAC would not have merged with LaneScan, and, without the Merger, LaneScan would have soon become insolvent.[346] Because LaneScan had little liquidation value,[347] the Merger was LaneScan's only chance to salvage some value for its owners.[348] Since the Court finds that the Director Defendants' motivation with regard to the challenged actions was to salvage whatever value they could for LaneScan's Members, not to enrich VSAC at the expense of LaneScan's Members, the Plaintiffs intentional misconduct claims fail.

E. *Fiduciary Duty Claims against Van Wormer*

The Plaintiffs assert a separate fiduciary duty claim against Van Wormer in his capacity as an officer. They do so, apparently, to take advantage of what they see as the broader fiduciary duties owed by officers to Preferred Members. Section 7.1 of the LLC Agreement, which limits the fiduciary duties of Members, directors, and officers, states, in pertinent part, that "[n]o Member, Director or

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[344] Tr. 148, 167. *See also* Van Wormer Dep. 252-53.
[345] Tr. 149-50. *See also* Tr. 341-42, 374-75.
[346] Tr. 141, 144, 149, 151, 223-26.
[347] *Id.* at 124-25, 245-46.
[348] *Id.* at 141, 149, 151, 225-26.

Officer shall have any duty to any Member or [LaneScan], except . . . in the case of an Officer, breach of such Person's duties pursuant to Section 4.6." Section 4.6(c) states that "[t]he Officers, in the performance of their duties as such, *shall owe to the Company* duties of loyalty and due care of the type owed by the officers of a corporation to such corporation and its stockholders under the laws of the state of Delaware" (emphasis added). Section 1.1 defines "Company" as LaneScan. Therefore, under a plain language reading of the relevant, unambiguous terms of the LLC Agreement, the fiduciary duties owed by officers pursuant to § 4.6(c) are only owed to LaneScan and are not owed to the Preferred Members. Thus, to the extent that the Plaintiffs' fiduciary duty claim against Van Wormer, in his capacity as an officer, is based upon fiduciary duties they claim he owed the Preferred Members under § 4.6(c), this claim fails, as Van Wormer did not owe the Preferred Members any fiduciary duties pursuant to § 4.6(c). The Court further notes that the Plaintiffs have brought all of their claims in their individual capacities and have not asserted any derivative or double derivative claims. To the extent that the Plaintiffs assert a fiduciary duty claim against Van Wormer, in his capacity as an officer, based upon the duties he owed the Preferred Members pursuant to § 7.1, these claims fail for the reasons explained *supra* Part V.D.

F. *Aiding and Abetting*

The Plaintiffs bring a claim of aiding and abetting intentional misconduct, breach of contract, and breach of the implied covenant against any Defendants that were not directly subject to those claims. Since each of the predicate claims upon which the aiding and abetting claim is based failed, so does the aiding and abetting claim.

G. *Laches*

Lastly, the Defendants argue that all of the Plaintiffs' claims are time-barred by laches.[349] As the Defendants recognize, "[t]he affirmative defense of laches generally requires the establishment of three things: first, knowledge [of a claim] by the claimant; second, unreasonable delay in brining the claim[;] and third, resulting prejudice to the defendant."[350] Although the Defendants complain that the Plaintiffs knew of their claim, waited an unreasonable amount of time before filing their claim, and had some nefarious motivation behind their opposition to the Merger, the Defendants presented no argument that, and pointed to no evidence showing that, they experienced prejudice as a result of the Plaintiffs' delay in bringing this suit. For this reason, the Defendants' laches defense fails.

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[349] This action was filed some sixteen months after the Merger.

[350] Defs.' Post-Trial Br. 27 (quoting *Homestore, Inc. v. Tafeen*, 888 A.2d 204, 210 (Del. 2005)). *See also* Defs.' Pre-Trial Br. 42.

VI. CONCLUSION

For the foregoing reasons, the Court grants the Plaintiffs' request for a declaratory judgment with respect to the Notes and the Security Agreement, and it reserves decision on the Plaintiffs' request for an award of legal fees and expenses related to the Notes Claims, to the extent such request is based upon § 2.3 of the Notes and the Plaintiffs' successful showing on the declaratory judgment claim. The Court rules in favor of the Defendants with respect to all of the Plaintiffs' other claims.

Counsel are requested to confer and to submit an implementing form of order.