

SAM GLASSCOCK III
VICE CHANCELLOR

**COURT OF CHANCERY
OF THE
STATE OF DELAWARE**

COURT OF CHANCERY COURTHOUSE
34 THE CIRCLE
GEORGETOWN, DELAWARE 19947

Submitted: February 13, 2012
Decided: February 15, 2012

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Re: *In re Estate of Everett T. Conaway*,
C.A. No. 6056-VCG

Dear Counsel:

I have reviewed your letters addressing the issue I raised at the November 18, 2011, Oral Argument regarding the identity of interests between Petitioner Jesse Frederick Conaway (“Jesse”)¹ and the Jesse Frederick Conaway Declaration of Trust (“JFC Trust”), together with the briefing and arguments on the cross-motions for summary judgment. This is my decision on those motions. Because neither party has pointed to an issue of fact material to the resolution of this dispute, pursuant to Court of Chancery Rule 56(h) I deem the case submitted for a decision based on the record submitted with the motions. For the reasons below, I find that the restraint on alienation in the EJKC Partnership, L.P., Agreement (“LPA”)

¹ I use the parties’ first names for clarity given their common last names, and intend no disrespect.

and Jesse's decision to withhold consent as a limited partner are valid, and that Everett T. Conaway's ("Everett") attempt to transfer his partnership interest to Respondent Janice Russell Conaway ("Janice") was invalid for lack of consent. Thus, the Petitioner's motion for summary judgment is granted, and the Respondent's motion for summary judgment is denied.

Background

First, a brief summary of the facts relevant to the LPA: On or about August 9, 2002, Everett and Jesse entered into a limited partnership agreement forming EJKC Partnership, L.P. ("EJKC" or the "Partnership"). The general partner of EJKC is Confam, Inc., a Delaware corporation ("Confam"). Confam's only shareholders were Everett and Jesse, each owning 50% of Confam's stock. Confam owns a 1% interest in EJKC. The original limited partners were Everett as trustee of the Everett T. Conaway Revocable Trust ("ETC Trust") and Jesse as trustee of the JFC Trust. The ETC Trust originally owned an 89% interest in EJKC, and the JFC Trust owned a 10% interest.

The LPA contains a restriction on the assignability of a partner's interest that requires a limited partner that wishes to transfer its partnership interest to first obtain the consent of the general partner and all non-

transferring limited partners. The specific language of the LPA provides, in relevant part:

Any Partner may transfer or assign his or her partnership interest in the Partnership to another Partner or Partners. Except as set forth herein, . . . the Limited Partner shall not sell, transfer or assign all or part of the Limited Partner's interest in the Partnership or substitute an assignee as Limited Partner without the written consent of the General Partner and non-transferring Limited Partner.²

The purpose of the LPA was to provide a mechanism by which Everett could make transfers of appreciated stock to Jesse through the transfer of limited partnership interests in EJKC, thus limiting tax exposure. This happened twice, in December 2004 and January 2005, and in both instances, the LPA was amended to assign an additional 10% interest from the ETC Trust to the JFC Trust. After these amendments, Confam owned 1% as general partner, and the ETC and JFC Trusts owned 69% and 30% as limited partners, respectively. The LPA also provided that the limited partners could withdraw from the partnership only with the consent of the other partners, and only by incurring a penalty of 50% of the withdrawing partner's equity.³ In agreeing to this withdrawal restriction and the

² Pet.'s Opening Br. App. Ex. 4, at 8-9 (LPA § 11) [hereinafter "LPA ____"].

³ The LPA provides:

No partner may withdraw from the Partnership without the written consent of the General Partner and the Limited Partner. The withdrawal of any Partner shall become effective on the date such withdrawal is consented to as herein set forth (the 'Effective Date'). Within thirty (30)

aforementioned restriction on alienation, it is clear that the parties intended to obstruct the acquisition of EJKC interests by third parties and to preserve the original purpose of the Partnership barring the consent of all the partners.

Over the years, Everett executed various amendments to his revocable trust and his Last Will and Testament (“Will”). Central to this case, however, is his Will dated September 21, 2009, which bequeathed household furnishings to Janice and the rest, residue, and remainder of his estate to the ETC Trust, dated September 3, 1993, as amended and restated September 21, 2009. The ETC Trust terminated once it received the remainder of Everett’s estate. Under the terms of the ETC Trust, Everett’s interest in EJKC was to pass to Janice. The purported transfer of the interest in EJKC to Janice, however, was a transfer for which Everett did not receive (and, as admitted by the Respondent, did not seek) the consent of the general partner, Confam, or the other limited partner, the JFC Trust. Additionally, the ETC Trust directed the balance of the ETC Trust corpus and any accumulated income to Jesse. Since Everett’s Will had transferred his Confam stock to the ETC Trust, the parties do not dispute that this latter provision transferred

days after the Effective Date, the Partnership shall purchase the Withdrawing Partner’s interest in the Partnership. The purchase price to be paid by the Partnership for the Withdrawing Partner’s interest shall be fifty percent (50%) of the Withdrawing Partner’s then capital account at the Effective Date.

LPA § 12.

Everett's shares in Confam to Jesse, making Jesse the 100% owner of that corporation. Jesse contends, however, that because the ETC Trust could not transfer its interest in EJKC to Janice without the consent of the JFC Trust, that purported transfer to Janice is void; accordingly, Everett's interest in EJKC passed to Jesse as residuary beneficiary of the trust, a transfer that did not require the consent of the partners.⁴ Under this view, Jesse is now the sole owner of all partnership interest in EJKC.

Jesse seeks a declaratory judgment that the terms of the LPA could not be superseded by the bequests in Everett's Will and the ETC Trust, both of which were executed after the formation of the Partnership. Janice contends that Jesse's withholding of consent constitutes self dealing and a breach of fiduciary duty, that the transfer restriction constitutes an unreasonable restraint on alienation, and that the transfer restriction runs afoul of Everett's intent as testator, which Janice alleges controls here.

Analysis

It is worth briefly discussing the contractual freedom that the Delaware Revised Uniform Limited Partnership Act ("DRULPA"), gives to parties entering a limited partnership agreement. As the statute states, "It is

⁴ The JFC Trust is a revocable trust with Jesse as trustor, trustee, and lifetime beneficiary. I therefore find that there is a complete unity of interests between Jesse and the JFC Trust and that, for the purposes of resolving this dispute, Jesse and the JFC Trust are interchangeable. Under the LPA, therefore, a transfer from the ETC Trust to Jesse did not require the consent of the partners.

the policy of [DRULPA] to give maximum effect to the principle of freedom of contract and to the enforceability of partnership agreements.”⁵ As Delaware case law has made clear,

the statute merely provides the “fall-back” or default provisions where the partnership agreement is silent. Thus, the provisions of the partnership agreement define the rights and responsibilities of those who are parties to the agreement and are afforded significant deference by the Courts. In fact, “where the parties have a more or less elaborated statement of their respective rights and duties, absent fraud, those rights and duties, where they apply by their terms, and not the vague language of a default fiduciary duty, will form the metric for determining breach of duty.”⁶

With this view of the contractual freedom Delaware law gives to parties entering a partnership agreement, I now turn to the terms of the LPA. I find that the LPA’s language is clear and unambiguous in its restriction on the transfer of partnership interests. The LPA quite plainly prohibits the sale, transfer, or assignment of any partnership interest absent the consent of the non-transferring partners. The LPA does not suggest that a transfer through a will or pour-over trust should be treated differently than any other transfer.

Having determined that the LPA plainly requires a transferring partner to obtain the consent of the non-transferring partners, and that Everett did

⁵ 6 Del. C. § 17-1101(c).

⁶ *Cantor Fitzgerald v. Cantor*, 2001 WL 1456494, at *5 (Del. Ch. Nov. 5, 2001) (footnotes omitted) (quoting *In re Marriott Hotel Properties II Ltd. P’ship Unitholders Litig.*, 1996 WL 342040, at *5 (Del. Ch. June 12, 1996)).

not obtain such consent, I now address the Respondent's arguments for why I should invalidate the transfer restriction.

The Respondent first argues that the Petitioner's withholding of consent constituted self dealing and a breach of fiduciary duty. The Petitioner is both a general partner through his sole ownership of Confam and a limited partner through his identify with the JFC Trust. Absent a modification in the partnership agreement, "a general partner owes the traditional fiduciary duties of loyalty and care to the limited partnership and its partners."⁷ By contrast, a limited partner owes no fiduciary duties to the partnership absent circumstances enabling the limited partner to exercise management or control over the partnership, thus creating a fiduciary relationship.⁸ Here, however, I do not need to reach the issue of whether Jesse's dual roles as a general and limited partner require him to meet fiduciary obligations when exercising rights available to him solely as a

⁷ *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 817 A.2d 160, 171 (Del. 2002).

⁸ See *Bond Purchase, L.L.C. v. Patriot Tax Credit Props., L.P.*, 746 A.2d 842, 864 (Del. Ch. 1999) (holding that a limited partner owed no fiduciary duties to the other limited partners because the limited partner had no right as limited partner to exercise management or control over partnership property); *KE Prop. Mgmt. Inc. v. 275 Madison Mgmt. Corp.*, 1993 WL 285900, at *9 (Del. Ch. July 27, 1993) ("[T]o the extent that a partnership agreement empowers a limited partner discretion to take actions affecting the governance of the limited partnership, the limited partner may be subject to the obligations of a fiduciary, including the obligation to act in good faith as to the other partners."); *id.* at *8 (positing that where a general partner and a limited partner are controlled by the same entity, "this might be sufficient to impose on [the limited partner] the same fiduciary duty" owed by the general partner).

limited partner. Even assuming I were to find that Jesse owes the full panoply of fiduciary duties when acting as a limited partner, his actions here would not have breached those duties, as he merely exercised his contracted-for rights under the terms of the LPA.

Nevertheless, the Respondent contends that Jesse unreasonably and in breach of fiduciary duty withheld his consent to prevent Everett from transferring his partnership interest. It is clear, however, that in entering the LPA, each party ceded his right to transfer his interest at will and without interference from the other party. This alienation restriction was clearly intended to preserve the purpose of EJKC, which was to provide a mechanism for Everett to make transfers to Jesse with limited tax exposure. Simply put, regardless of the extent of the duties Jesse owes as a limited or general partner, he did not breach those duties by exercising a contractual right, the purpose of which right was clearly to preserve the original partnership structure absent unanimous consent from the general and limited partners.

Moreover, it would be inequitable to allow Everett to circumvent the consent requirement in the LPA by making Jesse the sole owner of Confam. Jesse did not exercise complete control over Confam, the general partner, until Everett transferred his shares in Confam to Jesse through the ETC

Trust. It cannot be that in so transferring his Confam shares, Everett imposed fiduciary obligations on Jesse that require Jesse to consent to a transfer that he would otherwise oppose per his contractual rights. In any event, I do not find Jesse to be in violation of his fiduciary duties in withholding his consent as the LPA expressly permits.

The Respondent's other arguments also do not provide her with recourse. First, the transfer restriction is far from an unreasonable restraint on alienation. Rather, Everett and Jesse quite clearly restricted the assignability of their partnership interests to preserve the purpose of EJKC, which was to allow Everett to make transfers to Jesse with limited tax liability. The broad language of these transfer restrictions makes it clear that Jesse and Everett intended for it to be difficult to bring another party into that plan. Even if Everett had desired to withdraw from EJKC during his lifetime, he could have done so only with Jesse's consent and at a loss of 50% of his equity. Nothing in the LPA indicates an ability to make a transfer by will that could not be accomplished by transfer, or even withdrawal from EJKC, in life. Parties may freely enter partnership agreements, and they are free to restrict the transfer of partnership interests as they see fit.

Delaware law requires courts to honor the contractual intent of the parties. When the contractual language is unambiguous, the clear meaning of

that language determines the parties' intent. In this case, Everett and Jesse clearly intended to limit membership in the partnership to themselves, absent the consent of every partner. They included a restraint on alienation in the LPA to effectuate that intent, and I see no reason to invalidate that restraint.

Finally, the Respondent argues that the Petitioner's interpretation of the transfer restriction violates the principle of upholding the testator's (Everett's) intent. The testator's intent controls construction of his will; it cannot change preexisting contractual obligations. Everett's intent changed after he entered the LPA: by the time of his death he wished to transfer his interest to Janice. This change of heart does not invalidate Everett's contractual obligation to Jesse to obtain consent before transferring his partnership interest.

Conclusion

Based on the foregoing, I find that the restraint on alienation in the LPA is valid, as is Jesse's decision to withhold consent. Accordingly, Everett's attempt to transfer his partnership interest to Janice was invalid for lack of consent. The Petitioner's motion for summary judgment is therefore granted, and the Respondent's motion for summary judgment is denied.

IT IS SO ORDERED.

Sincerely,

/s/ Sam Glasscock III

Sam Glasscock III