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Transaction ID 6732708

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

FLIGHT OPTIONS INTERNATIONAL, INC., a Delaware corporation,	:	
Plaintiff,	:	
v.	:	**C.A. No. 1459-N**
FLIGHT OPTIONS, LLC, a Delaware limited liability company, KATHRYN GILCHRIST SIMPSON, LOUISE FRANCESCONI, CHARLES E. FRANKLIN, and WILLIAM LYNN,	:	
Defendants.	:	

MEMORANDUM OPINION

Date Submitted: July 7, 2005
Date Decided: July 11, 2005
Redacted Public Version: September 20, 2005

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NOBLE, Vice Chancellor

Plaintiff Flight Options International, Inc. ("FOI") owns approximately 31% of Defendant Flight Options, LLC, a Delaware limited liability company (the "Company"). Raytheon Travel Air Company ("RTA") owns approximately 69% of the Company. The Company has serious financial problems: debt obligations are coming due and it has insufficient funds to meet those obligations. RTA is prepared to provide $50 million to the Company, but only as an equity investment.[1] RTA and the Company have agreed through the Common Units Purchase Agreement (the "Purchase Agreement"), dated June 9, 2005, that RTA will issue 5 billion "Common Units" of common equity in the Company at $0.01 per unit. FOI has preemptive rights allowing it to participate on the same terms as RTA, but it has chosen not to exercise those rights. Recognizing, however, that consummation of the Purchase Agreement, now scheduled for as soon as the close of business on July 11, 2005, would dilute its equity interest in the Company to 1%, it brought this action to enjoin the Company from implementing the Purchase Agreement pending arbitration of their substantive disputes. FOI alleges that the Purchase Agreement violates the Second Amended and Restated Limited Liability Company Agreement of

[1] Since commencement of this action, RTA has formally offered to lend the Company another $32.4 million, but only if its proposed equity investment transaction closes.

Flight Options, LLC (the "LLC Agreement")[2] and is the product of the failure of the RTA-designated managers of the Company to discharge their fiduciary duties in accordance with Delaware law and to meet their obligations under the LLC Agreement. For the reasons set forth below, the Court will enjoin the proposed transaction for a period of 30 days to afford FOI the opportunity to seek continued interim relief in the arbitration forum which the parties have chosen for dispute resolution.

I. BACKGROUND

The Company does two things: (1) it is the world's second largest provider of fractional and aviation membership services;[3] and (2) it loses money.

The current structure of the Company, with RTA and FOI as its two members, traces back to March 2002 when the fractional aviation interests of RTA and its affiliates and of FOI and its affiliates were combined.[4] Since the formation of the Company, Raytheon and its affiliates have supported the Company with more than $300 million in debt and preferred equity investments. In contrast, FOI and its principals have contributed a paltry $2

[2] Verified Compl. Ex. C.

[3] With headquarters in Cleveland, Ohio, the Company has approximately 1,300 employees and 209 aircrafts and, in 2004, had revenues of $[redacted] million.

[4] RTA is a wholly owned subsidiary of Raytheon Aircraft Holdings, Inc. which, in turn, is a wholly owned subsidiary of Raytheon Company ("Raytheon"). For convenience, reference to "Raytheon" may include its subsidiaries.

million. As of June 2003, Raytheon had provided $48 million out of the $50 million contributed by the members of the Company. At that time, the parties entered into the LLC Agreement and the Investment and Restructuring Agreement (the "Restructuring Agreement").[5] As a result of the restructuring, RTA purchased additional common and preferred units of the Company, increasing its equity stake from 50.1% and gaining the right to appoint a majority of the Company's Board of Managers (the "Board").[6]

Under the LLC Agreement, the Company is governed by the Board which is supposed to have seven members. Four of its current members, Defendants Kathryn Gilchrist Simpson, Louise Francesconi, Charles E. Franklin, and William Lynn serve as designees of RTA and are employees or officers of Raytheon (the "RTA Managers"). Two other managers, Travis R. Metz and Robert P. Pinkas, were designated by FOI. The seventh position, reserved for the Company's chief executive officer, is vacant because there is no permanent chief executive officer.

The Company's need for additional cash infusions did not abate with the restructuring. By the end of 2004, Raytheon's separate investments had reached approximately $250 million. The Board members, including Metz

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[5] Cambria Aff., Ex. A.

[6] Before the restructuring, FOI had held approximately 49.9% of the equity interest in the Company. Also, before the restructuring, RTA and FOI had appointed an equal number of managers to the Board.

and Pinkas, were well aware of the Company's credit problems. For example, the October 5, 2004, Board minutes reflect the following: (1) counsel advised the Board of its duties "in a zone of insolvency context"; (2) the Company's management reported that Raytheon was resisting efforts to extend debt repayment deadlines; and (3) Raytheon was encouraging the Company to seek equity from some other source.[7]

The Board gathered a week later to approve a forbearance agreement that had been negotiated with Raytheon to delay repayment of debt owed by the Company. The minutes of that meeting also describe the fiscal exigencies that the Company was confronting and would be confronting on an ongoing basis.[8] Thus, by the end of 2004, the Board knew that 2005 would present significant debt management questions for its consideration.

The Board met on March 9, 2005. The Company's chief financial officer, Mark Brody, projected the need for additional cash flow of $██ million in April and in each of the next several months. Clearly, additional funding would be needed. Pinkas expressed his view that a third-party investment was unlikely until a permanent chief executive officer was installed and the Company's operating performance had improved. Company management was asked to "formulate a plan and process for the

[7] Cambria Aff., Ex. C.
[8] Cambria Aff., Ex. D.

Board to consider regarding how the Company could obtain an equity capital infusion in the longer term, and . . . outline for the Board how the Company would fund its short-term cash needs on its own."[9] In addition, Raytheon's proposal that the Company issue additional preferred equity units to RTA in connection with a new $█ million loan and certain forbearances by Raytheon was also addressed.

Company management had been assessing options for obtaining funding from other sources. As early as 2004, it had worked with Seabury Group LLC ("Seabury"), an investment banking, restructuring, and management consulting firm engaged in the transportation sector.

> Seabury identified the Company's maintenance and aircraft dispatch availability issues as one source of its financial problems. Seabury learned that the Company had a fleet wide reliability rate of approximately █ percent, meaning that the Company was able to provide Company-owned aircraft to its subscribers requesting air transportation only approximately █ percent of the time, often due to maintenance issues. For the remaining approximately █ percent of requests, the Company had to charter aircraft to serve its customers. The markedly higher cost incurred by the Company for charter aircraft was one of the reasons that the Company was not profitable.[10]

From its review of the Company's operational and financial circumstances, Seabury drew the following conclusions which it reported to Company management in March 2005:

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[9] The minutes of the March 9, 2005, Board meeting appear at Cambria Aff., Ex. F.

[10] Clauss Decl. at ¶ 13.

> [U]ntil the Company's fleet wide reliability, and associated maintenance problems, were greatly improved, the Company was highly unlikely to be able to raise capital from external sources and would need to continue to rely on funding from Raytheon. . . . [and] the Company likely would need to fix its maintenance and reliability issues and show profitability in two consecutive calendar quarters before it would be able to attract any interest from equity investors.[11]

At its April 4, 2005, meeting, the Board was informed of Seabury's gloomy conclusions. The Board approved, unanimously, the Company's borrowing from a Raytheon affiliate of $20 million with a maturity date of May 27, 2005 (the "Overline Loan"). Also approved was a forbearance agreement extending maturity of $█ million indebtedness to a Raytheon affiliate from March 2005 to May 31, 2005.

Company management also presented the Board with the results of an appraisal of the Company's common equity units by Standard and Poor's ("S&P"). The purpose was to support the Company's purchase of 6.5 million common units held by its former chief executive officer for no value. The repurchase of all of the units for the nominal consideration of one dollar was supported by the Board, including Metz and Pinkas.[12] The S&P draft

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[11] *Id.* at ¶ 14. The Defendants point to a "report" prepared by Seabury. *Id.*, Ex. A. While more in the nature of a presentation demonstrative, it does recite, at 4, that "[i]t is likely, in Seabury's opinion, that current equity shareholders will be wiped out, and that creditors will receive pennies on the dollar under all possible [restructuring] scenarios."

[12] Metz distances himself from the implications of this vote by noting that the chief executive officer had been terminated under circumstances that left him with little, if any, bargaining room. Metz Reply Aff. at ¶¶ 13-20. That, however, does not explain a similar

report suggested that the Company's fair market value was in the range of negative $ million. The final version of the S&P report[13] was received by the Company in mid-May and it was updated on May 26, 2005. The report, premised primarily upon Company financials and management projections, concluded that shareholder equity, as of December 31, 2004, was a negative $ million and that it would be at that level or worse through 2010. Accordingly, S&P assigned only "*de minimis*" value to the Company's equity units. S&P's report reflected: Company losses of $ million in 2003 and $ million in 2004; a projected loss of $ million in 2005; and a projected profit first occurring in 2008.

In the middle of April 2005, Charles F. Mueller, Raytheon's director of corporate development, contacted Jeffries Quarterdeck ("Jeffries"), a firm providing services relating to mergers and acquisitions, financing, and restructuring for companies in the aerospace and defense industries. After obtaining financial information from the Company and consulting with its chief financial officer, Jeffries was "unwilling to propose any type of financing for the Company because of its financial condition."[14] Indeed, it noted that the Company "lost money for every hour its planes were in the

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stance with respect to the repurchase a month later of 75,000 common units for no value from an employee who departed the Company, but without any cloud.

[13] Verified Compl., Ex. B.

[14] Richter Decl. at ¶ 6.

air."[15] Jeffries drew the following conclusions: (1) "[u]ntil the Company addressed the underlying operational causes for its losses, . . . there was no possibility of arranging external debt or equity financing for the Company at that time" and (2) any "external financing could be accomplished only at extraordinary interest rates or by essentially giving up equity control of the Company."[16] These conclusions were reported to the Board on May 13, 2005.

The Company owed Madison Capital, one of its few third-party lenders, $14 million that was due on May 27, 2005. The debt had been guaranteed by Metz and Pinkas, but they were refusing to extend their guarantees. Accordingly, at the May 13, 2005, Board meeting, in addition to reporting Jeffries' conclusions, Company management informed the Board of the guarantors' decision and the Company's need for (1) $14 million to repay Madison Capital; and (2) $23 million to meet projected cash flow needs for the balance of 2005. On May 10, 2005, RTA had submitted a term sheet for its purchase of new equity.[17] That term sheet, which would form the basis for the Purchase Agreement now challenged by FOI provided: (1) an increase in the Overline Loan from $20 million to $50 million ($14

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[15] *Id.*

[16] *Id.* at ¶¶ 7-8. Neither Jeffries nor S&P would provide any formal opinion to the Company regarding either the fair value of the common units or of the Purchase Agreement.

[17] Cambria Aff., Ex. I.

million of which was to repay the Madison Capital loan); (2) a maturity date for the increased Overline Loan of June 30, 2005; (3) the issuance on June 30, 2005, of $50 million worth of common units of the Company, valued at $0.01 per unit, to RTA and to any other equity holder who chose to exercise preemptive rights in connection with the issuance; and (4) a forbearance by Raytheon until March 2006 of approximately $█ million of debt that would come due in 2005. The sale price for the equity units of $0.01 per unit was subject to confirmation by an independent appraiser that the fair market value was equal to or less than the specified unit price.

Pinkas opposed the proposed equity financing and indicated that there were third parties interested in investing in the Company. He did not identify those third parties, except for Apollo Management, L.P., a firm that representatives of RTA had already contacted. The Board unanimously approved the additional debt financing proposals and it authorized, although over the opposition of Pinkas and Metz, Company management to negotiate with RTA over the terms of the equity financing and to retain S&P to value the common equity units.

Raytheon had been meeting the cash needs of the Company for more than two years without any assistance from FOI. With the forbearance agreements and increasing indebtedness, it was becoming more deeply

involved in its apparent role as lender of last resort. Indeed, the Overline Loan was intended to be of short duration, but it was obvious that the Company would have great difficulty in repaying it when it became due on June 30. Raytheon's position evolved to a willingness to delay repayment of certain debt and to extend additional financing, but all would be conditioned upon the closing of the Purchase Agreement.[18] Thus, as of June 9, 2005, the Company and Raytheon executed the Purchase Agreement and another forbearance and deferral agreement. On July 1, 2005, after the filing of this action, Raytheon also submitted a term sheet offering to provide new financing in the amount of $32.4 million.[19]

After the May 13 Board meeting, when it had become obvious that an RTA equity investment would occur, the Company's outside counsel contacted Metz and Pinkas for assistance in negotiating with RTA for a more favorable price. No response was received. On May 24, 2005, Company management wrote to representatives of RTA and FOI asking that they identify potential investors. RTA made two suggestions the next day. A week later, Pinkas identified three potential investors.

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[18] The sale of the 5 billion common units to RTA would provide the Company with no new cash. Instead, it would accomplish a conversion of debt to equity.

[19] Mueller Decl., Ex. B.

In the intervening weeks, representatives of either the Company or Raytheon discussed possible investments in the Company with six different entities. Three, after receiving financial information, either did not respond or responded with a lack of interest. Three other entities engaged in more substantive discussions with Company management:

1. UIJ Aviation, a Canadian aviation venture, indicated that it valued the Company's equity at zero and that Raytheon would receive only "cents on the dollar" for its debt but that it might require more if it agreed to a deferred payment schedule. In addition, UIJ expressed an interest in receiving special concessions from Raytheon in contracts for aircraft maintenance. Raytheon was unwilling to relinquish its indebtedness rights and would not provide special terms to UIJ for its maintenance work; accordingly, UIJ has indicated that it is not interested in any transaction involving the Company.

2. Apollo Management, L.P. appears to have given serious thought to an investment in the Company. It took the position that the Company's equity was of "no value" and that its debt was worth less than face value. It submitted a written proposal, dated April 12, 2005, that any acquisition of the Company would provide no return for equity holders and only a partial return on debt. It also indicated that it desired to acquire

certain other Raytheon assets which were not for sale. In light of that response, no further negotiations occurred.

3. Assets Solutions International, Inc. ("ASI") met with Company management on June 22, 2005. It is continuing to conduct due diligence following an expression of interest in purchasing and acquiring common equity if the Company's debt could be addressed as well. Although ASI's request for an exclusivity period until July 10, 2005, was denied, ASI has continued its due diligence and its discussions with representatives of RTA, FOI, and the Company.[20]

The Company's outside counsel, on May 31, 2005, sought to enhance the terms of the Purchase Agreement, by seeking a higher price per unit, an extension of due dates for other indebtedness, and a post-closing adjustment to the purchase price in the event any higher price was paid by a third party within a twelve month period. Raytheon rejected those efforts, but it did consent to including a "fiduciary out" in the Purchase Agreement.[21] Following execution of the Purchase Agreement, all eligible equity holders,

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[20] It is now apparent that ASI will not present a material offer before the close of business on July 11, 2005.

[21] The "fiduciary out" feature is limited in scope and requires a "definitive written agreement" for a Superior Investment Proposal and a $50 million cash (or equivalent) payment by July 10, 2005. Purchase Agreement, Section 9.2. To be a Superior Investment Proposal, it must, *inter alia*, "as a whole, present[] a more favorable opportunity for Flight Options that the transactions contemplated by [the Purchase Agreement]." Purchase Agreement, Section 1.1.

including FOI, were sent a preemptive rights notice. No notice of intent to assert preemptive rights had been submitted by the June 30 deadline.

The Company had a net loss of approximately $█ million through May 2005 and it was expected to lose $█ million in June. As of July 1, the Company had cash reserves of approximately $█ million but owed Raytheon Aircraft Services roughly $█ million for maintenance services. Although the Overline Loan is to be repaid by July 11, 2005, the Company does not have the ability to do so. In addition, another $█ million will be required during the balance of 2005 to satisfy working capital requirements and to pay a $█ million facility mortgage note to a third-party lender which becomes due in August 2005.[22]

II. CONTENTIONS

A. *From FOI's Perspective*

FOI acknowledges that Raytheon and its affiliates control both the equity and the debt of the Company. The Purchase Agreement does not provide for any new funds for the Company. It simply accomplishes a

[22] With respect to the additional financing proposed by the July 1, 2005, term sheet in the amount of $32.4 million, $12.5 million has already been used to pay off a third party creditor which was threatening litigation. In the absence of third-party funding or further funding by Raytheon, the Company will not be able to need its financial obligations or to continue operations. Because there is no reasonable expectation that a third-party lender or investor will appear by July 11, 2005, the Company's fate, and that of whatever interest FOI may have, rests with Raytheon and how it will, in fact, exercise its powers as the Company's, while not exclusive, most significant creditor.

conversion of Raytheon debt to Raytheon equity and whether that happens on July 11, 2005, or sometime later should make little difference to Raytheon. FOI, however, maintains that it makes a big difference to FOI because its equity interest in the Company will be eviscerated for no consideration. The decision that the Company's common equity is worthless is, according to FOI, unfair and unjustified. Because Raytheon controls "both sides" of the transaction, the actions of its representatives must be judged under the "entire fairness" standard. In addition, FOI is contractually entitled to a price set through an "arms' length" transaction. The Purchase Agreement meets neither of these standards. Thus, FOI argues, there is a reasonable probability that it would prevail on its claims before the arbitration panel. In addition, the severe reduction of its equity interest will constitute irreparable harm and a balancing of the equities favors granting it relief because it will suffer palpable harm without interim injunctive relief, but neither the Company nor RTA will suffer any adverse consequences because Raytheon will not capriciously harm an entity into which it has made such a sizeable investment.

B. *From the Defendants' Perspective*

The Defendants vigorously contest FOI's claims. Initially, they stress that the Company only exists because of Raytheon's long and substantial

commitment to funding its operations. The Company has a negative balance sheet; it loses money; and its prospects for a turn around in the short term are bleak. Equity value simply is not there. Moreover, FOI could have protected its interests through the exercise of its preemptive rights to acquire additional equity on the same terms as RTA. The Defendants also point out that irreparable harm will not result. Raytheon's participation will likely be on a continuing basis and rescission may be an adequate remedy. Alternatively, the diminution in value can be determined and, thus, damages would also be adequate—all in what Defendants view as the unlikely event that FOI should prevail on the merits of its claims. Finally, because of the unquestioned and immediate need of the Company for additional funding, which Raytheon is now committed to accomplishing in the event the Purchase Agreement is consummated, and the history of FOI's failure to participate in meeting the Company's ongoing cash needs, the equities align against the issuance of a preliminary injunction.

III. ANALYSIS

A. *The Appropriate Standard*

A plaintiff seeking a preliminary injunction bears the burden of demonstrating: (1) a reasonable probability of success on the merits at trial; (2) that it will suffer imminent, irreparable harm if its application is denied;

and (3) that the harm to the plaintiff, if relief is denied, outweighs the harm to the defendant if relief is granted.[23] The preliminary injunction, here, is sought in aid of arbitration. That requires an analysis of the likelihood of success prong at two levels: (1) the moving party's entitlement to arbitration; and (2) the merits of its arbitration claims.[24] The parties agree that the dispute among them is to be resolved by arbitration.[25] Moreover, "where the right to arbitrate is clear," as here, "the analysis of the merits of the underlying claims may be more limited."[26] This "more limited" standard has been framed as requiring the party seeking the preliminary injunction only to "establish a reasonable probability that its arbitration position is sound."[27]

B. *Probability of Success on the Merits*

FOI has not yet filed a demand for arbitration. Accordingly, it is something of a challenge to determine whether a preliminary injunction

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[23] *See, e.g.*, *SI Management, L.P. v. Wininger*, 707 A.2d 37, 40 (Del. 1998); *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1371 (Del. 1995).

[24] *Kansas City S. v. Grupo TMM, S.A.*, 2003 WL 22659332, at *2 (Del. Ch. Nov. 4, 2003).

[25] The LLC Agreement requires arbitration of "any dispute, controversy or claim" between a member and another member, or between a member and the Company. Section 18.2. In addition, the arbitration provisions include any dispute, controversy or claim between a member and an affiliate of a member. Affiliate is defined to include the managers of the Company, in this instance, the RTA Managers. App. at B-2.

[26] *Kansas City S.*, 2003 WL 22659332, at *2 (quoting *Price Org., Inc. v. Univ. Computers Servs., Inc.*, 1992 WL 356026, at *8 (Del. Ch. Dec. 2, 1992)). *But see Suchodolski Assocs., Inc. v. Cardell Fin. Corp.*, 2004 U.S. Dist LEXIS 1427, at *12 (S.D.N.Y. Feb. 3, 2004) (rejecting a more relaxed standard of review for a "status quo" injunction pending further proceedings in arbitration).

[27] *Id.* In *Kansas City Southern*, the Court did not resolve the question "as to how much the Court should limit its inquiry." *Id.* at n.10.

should issue in aid of an arbitration where the grounds for the arbitration have not been set forth in that forum. The Court's understanding of the claims that FOI intends to present to the arbitrators includes the following: (1) that the $0.01 per unit price at which the Company will issue to RTA new common units is unfair and unwarranted; (2) the Board failed to conduct an adequate "market check" in advance of approving the Purchase Agreement on June 9, 2005; (3) the "fiduciary out" negotiated by the Company's outside counsel is illusory because of its limited scope and short duration. The parties diverge at the outset over whether the conduct of the RTA Managers is to be judged under the "entire fairness" standard or whether their obligation is to satisfy an "arms length" standard set forth in the LLC Agreement.[28]

By 6 *Del. C.* § 18-1101(c), Delaware's Limited Liability Company Act (the "Act") provides:

> To the extent that, at law or in equity, a member or manager or other person has duties (including fiduciary duties) to a limited liability company or to another member or manager or to another person that is a party to or is otherwise bound by a limited liability company agreement, the member's or

[28] The Defendants concede that the RTA Managers "stand on both sides" of the Purchase Agreement. If they are subject to the full panoply of fiduciary duties in this case, the appropriate standard for review of their conduct would be "entire fairness;" that is, they would be required to demonstrate that the Purchase Agreement was entirely fair as to price and process.

> manager's or other person's duties may be expanded or restricted or eliminated by provisions in the limited liability company agreement; provided, that the limited liability company agreement may not eliminate the implied contractual covenant of good faith and fair dealing.

Thus, it is necessary to turn to the LLC Agreement. By Section 6.5(b), the LLC Agreement imposes the following standard: "Each Manager shall have the same fiduciary duties in managing the affairs of the Company as the directors of a Delaware corporation have, under applicable law, to its shareholders and others, as applicable."[29] On the other hand, by Section 6.2(l), the LLC Agreement establishes the following standard to govern transactions between the Company and any affiliate of the Company:

> Unless otherwise approved by a majority of disinterested Managers, all transactions between the Company on the one hand, and any Affiliate of the Company on the other hand, will be on arms' length terms and conditions, including fair market values and prices equivalent to those that would be charged and paid between parties at arms' length at the time of the entering into of the transactions in question.

The parties who are bound by the LLC Agreement are sophisticated parties, and it is the Court's burden to discern the intention of the parties in defining, through the LLC Agreement, the obligations of RTA and the RTA

[29] Pursuant to Section 6.6 of the LLC Agreement, "[e]ach Member shall have the same fiduciary duties to each other Member as the shareholders of a Delaware corporation have, under applicable law, to each other."

Managers to the Company and to other stakeholders.[30] When the LLC Agreement was negotiated, it was obvious that a majority of the Board would be comprised of RTA designees. Thus, in any transaction between the Company and Raytheon, or one of its affiliates, the RTA Managers would find themselves in a position of inherent conflict where their loyalty would always be fairly subject to question. It is with this in mind that the LLC Agreement must be construed. "It is, of course, a maxim of contract interpretation that more specific contractual terms will trump those that are more general."[31] Section 6.2(l) specifically is targeted at transactions between the Company and its affiliates, and it is more specific with respect to assessing the conduct of the RTA managers in a related party transaction than would be the more general fiduciary duty provision of Section 6.5(b). In short, the LLC Agreement imposes general fiduciary duties upon the managers but, in the context of a transaction between the Company and its affiliates, those duties are limited to requiring that the transaction be on "arms' length terms and conditions"[32] and, in accordance with § 18-1110(c)

[30] *See Kier Constr., Ltd. v. Raytheon Co.*, 2005 WL 628498, at *5 (Del. Ch. Mar. 10. 2005).
[31] *Fasciana v. Elec. Data Sys. Corp.*, 829 A.2d 160, 173 n.44 (Del. Ch. 2003).
[32] The notion of arms' length terms and conditions conjures up an image of real negotiations—the process of give and take. It is doubtful that any such activity occurred between the Company and Raytheon to any significant extent. The terms and conditions of the Purchase Agreement were largely set by Raytheon. The capacity of Company management to negotiate effectively with Raytheon may be questioned because the

of the Act, carried out in good faith and through fair dealing.[33]

In accordance with the LLC Agreement, the RTA Managers must justify their approval of the interested party transaction as one on "arms' length terms and conditions."[34] FOI does not question the terms and conditions of the Purchase Agreement other than the price and, perhaps, the provisions of the "fiduciary out" clause. Through Metz's affidavit, FOI sets up its claim relating to the price of the common units and S&P's supporting

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Company apparently is in the zone of insolvency and Raytheon controls the equity and is the principal creditor. Of course, as the result of negotiations, a limited "fiduciary out" clause was added. As a practical matter, the inquiry must be one of whether the price fairly reflects what would have been the outcome of an arms' length negotiation. The reliability of a determination of price cannot be fairly assessed, at least in this context, without consideration of the process.

[33] At issue here is the scope of the fiduciary duties owed by the RTA Managers to the Company. The definition of "Affiliate" appears in Appendix B of the LLC Agreement. It means, "with respect to any Person: (i) any Person directly or indirectly controlling, controlled by or under common control with such Person; . . ." Because RTA controls the Company, whether through its ability to designate a majority of the board of managers or by its effective equity control, RTA is an "affiliate" of the Company.

It should be noted that the arbitrators might take a different view. The LLC Agreement broadly imposed fiduciary duties on the RTA Managers. A limitation on those important duties should have been, it could be determined, more precisely delineated and, if resort to a contract construction principle of the specific provision controlling the general provision is needed, then Section 6.2(l) was not adequate to achieve the results sought by the Defendants.

[34] The burden of demonstrating that the Purchase Agreement is based on an arms' length price is properly imposed upon the RTA Managers because that is the standard prescribed in the LLC Agreement for them to justify their conduct, instead of the more onerous "entire fairness" standard, a burden which, if applicable, clearly would be theirs.

valuation.[35] Metz, who does not claim to be an independent valuation professional in this matter,[36] expresses the view that each common unit is worth $1.44.[37]

FOI also argues that the process adopted by the RTA Managers was so flawed as to cast doubt upon the value established through that process for the new common units. First, it points out that the Company never retained an investment adviser and it did not receive a formal opinion from either Seabury or Jeffries. Second, FOI contends, quite plausibly, that the

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[35] Metz notes that S&P used only a discounted cash flow analysis, eschewing other potential methodologies to determine value.

[36] Metz does have experience in valuing businesses as part of his duties as a managing director of a private equity investment firm that manages more than $1.5 billion. FOI did not submit an independent cash flow analysis. The reasons for that tactical choice are not clear although one is tempted to wonder about the conclusions that might have been drawn.

[37] Metz Aff. at ¶ 12. A detailed review of Metz's attack on the S&P discounted cash flow analysis, Metz Aff. at ¶¶ 5-12, would serve little purpose in the context of a preliminary injunction motion. It is sufficient to note that his concerns are fairly addressed in the Deetz Decl. at ¶ 7-10.

If the common units are worth $1.44 each, one wonders why the preemptive rights were not exercised. FOI chose not to do so (perhaps because it did not have the resources), but that does not explain why FOI could not have induced others to participate (or assist it in participating) if, in fact, the units were worth 144 times the purchase price. While there is no duty to exercise preemptive rights, these sophisticated parties included no dilution protection feature in the LLC Agreement, except for the preemptive rights provision that allows each member to amass equity units on the same basis as the other member.

FOI also attacks the independence of S&P because Raytheon is an "S&P client." Verified Compl. at ¶ 33. FOI offers nothing more and what it has alleged has no suggestion of materiality and, thus, fails to cast any doubt on S&P's independence. *See, e.g.*, *NBC Universal, Inc. v. Paxson Communications Corp.*, 2005 WL 1038997, at *7-8 (Del. Ch. Apr. 29, 2005).

Company has favorable future prospects.[38] The impact of potential future prosperity on current value was not, according to FOI, given appropriate weight. Third, Apollo Management's position reflected the first response to a solicitation that was then cut off by the Raytheon interests. As such, it was only the opening salvo in a negotiation that never went further. Accordingly, it is an unreliable reference.

Thus, it is against this backdrop that the Court must determine whether FOI has "establish[ed] a reasonable probability that its arbitration position is sound."[39] That question is not whether the Court, in the absence of an agreement by the parties to submit the merits of their dispute to an arbitration panel, would enjoin the issuance of new common units to RTA. Instead, it requires an assessment, however imprecise, as to how FOI's claims would likely be received in the arbitration forum. It is not simply a question of whether the claims to be submitted to the arbitrators are colorable; nor does it require certainty that a favorable result will be obtained. Instead, FOI must persuade the Court that the arbitration panel could find in its favor and that there is a reasonable possibility of such a

[38] That, of course, is premised on an assumption that the Company survives until the "future" arrives. To be sure, the Company does have serious difficulties that extend beyond its current liquidity crisis. For example, the Company's churn rate (a function of customers lost measured against customers gained) is above the industry average. *See* Deetz Decl. at ¶ 11(iv).

[39] *Kansas City S.*, 2003 WL 22659332, at *2.

result. It is important for the Court not to impress its views of this matter on the venue chosen by the parties for the resolution of their dispute. Thus, the Court must be careful in predicting the outcome in the arbitration forum. Ultimately, it is a question of whether FOI has come forward with a showing that its claim is sufficient to accommodate these considerations.

The evidence that the price of the new Common Units is a fair reflection of what would have been reached in an arms' length transaction consists of: (1) the S&P valuation; (2) the "opinions" from Seabury and Jeffries; and (3) a limited marketing or "market check" effort. Each has its shortcomings. The S&P valuation is not unreasonable, but it relies exclusively on the discounted cash flow method. While the discounted cash flow approach may have been the single best tool, other methodologies were not employed as a check.[40] In addition, the Company's relatively short history and the difficulty of projecting its cash flows into the future all counsel for caution. Moreover, S&P did not explore in depth the nature of the industry and its prospects. With respect to Seabury and Jeffries, the intensity of their efforts cannot readily be discerned from the affidavits

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[40] S&P acknowledges the usefulness of other methodologies—the Guideline Company Method and the Comparable Company Method. It states that the necessary information to employ other methodologies was not available, but it is not clear why that is the case. Verified Compl., Ex. B, at ¶ 6.3.

presenting their conclusions.[41] In addition, Jeffries' involvement was solicited by Raytheon's director of corporate development, *i.e.*, not by anyone directly associated with the Company. Neither Jeffries nor Seabury offered a formal opinion. Again, while ultimately none of this may matter, there is room for doubt. The effort to obtain proposals—an effort to secure an accurate read of market perception—was done in a haphazard manner. The results may accurately reflect the market, but the lack of coordination and process, again, tends to undermine the results. Finally, the "fiduciary out" provision which requires a "definitive written offer" and the delivery of $50 million within approximately one month of approval of the Purchase Agreement, does not support the reliability of the established price because the short period offers only limited opportunity for any potential investor to pursue necessary due diligence and to arrange for the required funding.

The question, of course, is not how the Court views the valuation information as a whole; it is how the arbitrators would view it. The Court is satisfied, however, that there is a likelihood that the arbitrators would find FOI's challenge to be sound: that they would conclude that the fate of a company with revenues in excess of $███ million annually and the fate of an

[41] Because of the compressed schedule for considering the preliminary injunction application, admittedly due largely to FOI's delay in filing this action, no depositions were taken.

almost one-third interest in the Company should not be based on a price established by such a process. Raytheon controlled the setting of the price; while it may eventually be sufficient for it to argue that the balance sheet and the cash demands demonstrate an absence of value in the equity, the process chosen was so informal as to undermine substantially the ability of the RTA Managers to show that the price is the equivalent of an arms' length transaction's result, at least within the projected views of an arbitration panel.[42] Accordingly, under the in aid of arbitration standard, FOI has met its merits-based burden.

C. *Irreparable Harm*

Without irreparable harm, there is no need for the Court to grant interim relief and the parties can fairly wait until final decision on the merits. Winning sooner, instead of later, is, of course, preferable. When a court enters a preliminary injunction, it does so frequently without a full understanding of the facts and without the parties' having had the

[42] Although the Act provides that drafters of limited liability company agreements may relieve managers of some of the burdens of fiduciary duties, the duty of good faith must remain. FOI alleges that the RTA Managers failed to meet their duty of good faith. The Court is satisfied, at least on the present record, that FOI has not demonstrated any basis for finding a breach of the duty of good faith, even under the in aid of arbitration standard. There is no reason to doubt that the RTA Managers reasonably and in good faith believed that the Common Units were of no (or *de minimis*) value and that the proposed financing was in the Company's best interest. The balance sheet is negative, cash needs cannot be met, and the debt is substantial. In addition, they had the benefit of the S&P valuation. Their views may be wrong (or they may be right), but for these purposes, their conduct cannot be viewed as resulting from a lack of good faith.

opportunity to develop fully their advocacy positions. Thus, courts must be careful in awarding such relief; indeed, it is said that a "preliminary injunction is an extraordinary remedy,"[43] and it is crucial for the successful plaintiff to demonstrate that it will suffer irreparable harm in the absence of judicial intervention.

FOI starts with the argument that it need not make a showing of irreparable harm. It relies upon Section 21.13 of the LLC Agreement, which provides in pertinent part:

> **Specific Performance**. The parties acknowledge that it is impossible to measure, in money, the damages that shall accrue to a party . . . from a failure of a party to perform any of the obligations under this Agreement. Therefore, if any party . . . enters into any action or proceeding to enforce the provisions of this Agreement, any Person (including the Company) against whom the action or proceeding is brought waives the claim or defense that the moving party . . . has or shall have an adequate remedy at law, and the Person shall not urge in the action or proceeding the claim or defense that an adequate remedy at law exists.

While this language perhaps could be read as requiring the court to be more flexible in assessing whether FOI has made the necessary showing, it is not dispositive.[44] First, it only addresses the question of an adequate remedy at

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[43] *Lawson v. Meconi*, 2005 WL 1323123, at *2 (Del. Ch. May 27, 2005).

[44] The Defendants argue that Section 21.13 can have no application here because it bears the heading "Specific Performance" and this is not an action for specific performance. They are right: Section 21.13 of the LLC Agreement bears the heading "Specific Performance" and this is not an action for specific performance; however, by Section 21.7 of the LLC Agreement, "Section and other headings contained in this

law—a necessary predicate to the exercise of equitable jurisdiction without regard to whether the plaintiff seeks interim or permanent equitable relief. It does not specifically address the more precise aspect of irreparable harm. In short, there are instances where there may not be an adequate remedy at law but there, at the same time, may not be the potential for irreparable harm. Second, the parties may not confer equitable subject matter jurisdiction upon this Court by agreement.[45] Thus, further consideration is required.

Consummation of the Purchase Agreement will dilute FOI's equity interest in the Company from 31% to 1%. A severe dilution has been found to constitute irreparable harm because, at least in part, of the difficulties in restoring the injured party to its proper status through a grant of final relief.[46] However, there is no general rule that applies to all circumstances. Instead,

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Agreement are for reference purposes only and are not intended to describe, interpret, define or limit the scope or extent of this Agreement or any provision hereof." The text of Section 21.13 cannot be fairly read as limited to specific performance actions only.

[45] As to the capacity of contracting parties under circumstances, not present here, to confer subject matter jurisdiction by contract, see 10 *Del. C.* § 346.

[46] *See, e.g.*, *Suchodolski Assocs. v. Cardell Fin. Corp.*, 2004 U.S. Dist. LEXIS 1427 (S.D.N.Y. Feb. 3, 2004). The parties all cite *Solar Cells, Inc. v. True N. Partners, LLC*, 2002 WL 749163 (Del. Ch. Apr. 25, 2002), which, while instructive, involves a more "injunction-friendly" set of facts. More than equity dilution (*e.g.*, dilution of role in corporate governance) was at stake there. Also, the challenged dilution was accomplished in what the Court considered an underhanded manner. Here, Metz and Pinkas were aware of the substance of the Purchase Agreement well in advance of the June 9 meeting and, for another month, have had, although on a limited basis, the opportunity to pursue other options. There is one aspect about *Solar Cells* which may be viewed as putting FOI's claims in a better light. The fiscal difficulties experienced in *Solar Cells* resulted from claims of third-party creditors; here, the creditor of consequence—Raytheon—is also the party which is acquiring the enhanced equity position as the result of dilution of FOI's interest.

a case-by-case analysis, considering the various potential consequences of the dilutive conduct is necessary.[47]

The Defendants have cogent arguments as to why a finding of irreparable harm may not be appropriate. First, the benefits of dilution will accrue to Raytheon; Raytheon will likely, but with no guarantee, continue holding that equity; under the LLC Agreement, Raytheon will be required to give notice to FOI of any proposed transfer of its equity interest; and, thus, the arbitration panel would likely be confronted with a factual setting in which, if applicable, rescission could be accomplished. Second, the value of FOI's interest in the Company before and after the issuance of the new equity can be determined—even if imprecisely—and, thus, damages could be fairly measured. If damages are available, the Defendants point out, the harm cannot be said to be irreparable. Finally, the dilution of FOI's equity interest will not impair its right to designate two members of the Board. As the Defendants argue, but with little comfort for FOI, FOI's role in corporate governance through the Board will not be diminished.

In response, FOI notes that the LLC Agreement exculpates the RTA Managers from personal liability for money damages to the extent that "their act[s] or omission[s] [were] taken or omitted in good faith and in a manner

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[47] *See Rovner v. Health-Chem Corp.*, 1996 WL 377027, at *13 (Del. Ch. July 3, 1996) (considering the impact of voting power dilution).

that the Covered Person [Manager] reasonably believed to be in or not opposed to the best interests of the Company or permitted by the [LLC Agreement]."[48] On the other hand, the exculpatory provision does not extend to RTA. Nevertheless, FOI's ability to collect damages from the RTA Managers, in the event that it should prevail on the merits of its claims, is, at best, problematic.

Although rescission may be more likely in this matter to be a viable remedy than it frequently is, there remain a number of substantial impediments. These range from the possibility, even if not the likelihood, that Raytheon will sell its interests in the Company to the likelihood that further changes will be made in the Company's capital structure thereby making rescission less facile. Moreover, the process of calculating the diminishment in value (of course, assuming that there would be any) may be a daunting task.

In sum, reducing FOI's equity interest in the Company from 31% to 1% may fairly be characterized as irreparable harm.

D. *Balancing of the Equities*

If the Purchase Agreement is implemented, FOI's significant equity position will be reduced to approximately 1% of the Company and, if that is

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[48] LLC Agreement, Section 7.3(a).

done improperly, restoring to FOI its former position or fairly compensating it for its loss will be problematic. As for the Company, this is not a dispute where some third-party investor or creditor may do substantial harm to it in the absence of the proposed transaction. Raytheon, of course, will act as it chooses as creditor. If it chooses to force the issue, it can cause the parade of horribles posited by the Company—loss of jobs, closing of facilities, defaults on contracts. That harm, however, will be caused to an entity in which Raytheon holds approximately 69% of the equity. In short, in balancing the equities between the Company and FOI, the balance tips slightly in favor of FOI. The interests of the RTA Managers, as such, would not be adversely affected by the entry of a preliminary injunction.

E. *Propriety of a Preliminary Injunction*

FOI has succeeded, although by the barest of margins, under the relaxed standard associated with preliminary injunctions in aid of arbitration in demonstrating a likelihood of success, the occurrence of irreparable harm in the absence of interim relief, and a favorable balancing of the equities.[49]

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[49] The Defendants argue that equitable relief should be denied to FOI because of its delay in pursuing this action. It took from June 9, 2005, when the Purchase Agreement was applied (and those terms had been known for perhaps as long as a month before then) until June 27, 2005, to file this action. The defense of laches "operates to prevent the enforcement of a claim in equity if the plaintiff delayed unreasonably in asserting the claim, thereby causing the defendants to change their position to their detriment." *Scureman v. Judge*, 626 A.2d 5, 13 (Del. Ch. 1992). It appears that efforts to avoid litigation were pursued during the interim; it appears that the Defendants did not change

Thus, a preliminary injunction, as described below, will issue to maintain the status quo pending commencement of the arbitration proceeding between the parties and the arbitration forum's opportunity to review the need for continuing interim relief.

IV. CONCLUSION

The Company's future depends upon what Raytheon plans to do with, or to, it. This Court's actions in the context of a motion for a preliminary injunction in aid of arbitration are likely to be of little, if any, long-term consequence for the Company. Raytheon controls the Company's Board of Managers, it controls the Company's equity, and its credit position is overwhelming. Although obviously dependent upon the course chosen by Raytheon, FOI's interest in the Company is likely limited in terms of both value and duration. The parties agree that their disputes should be resolved through arbitration; without a preliminary injunction, the ability of the arbitrators to protect the interests of FOI, as limited as they may be as a practical matter, would be impaired. In light of the relaxed standard for a preliminary injunction in aid of arbitration, it is appropriate for the Court to exercise its discretion to maintain the status quo.

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their position during the interim; under the circumstances, it is difficult to say that the delay was unreasonable. Thus, laches is not available as a defense to FOI's motion for a preliminary injunction.

FOI's application for interim injunctive relief is not without its unappealing aspects. It negotiated the Restructuring Agreement and the LLC Agreement which diluted its interest without securing any future protection from dilution except through the preemptive rights provision. It now has elected not to exercise those rights. Since the formation of the Company, as now constituted, FOI and its affiliates have contributed a pittance to slake the Company's thirst for cash, but it willingly allowed Raytheon to fund, and to fund, and to fund those needs. The arbitrators may well finally conclude that FOI is not entitled to relief. Moreover, they may conclude that FOI is not entitled to relief pending their final resolution of the parties' dispute. The LLC Agreement specifically authorized the pursuit of interim relief in the arbitration forum under the American Arbitration Association's Optional Rules for Emergency Measures of Protection.[50] That established the proper process for determining whether the status quo should be maintained for the duration of the arbitration proceeding and its respects the parties' agreement to submit this dispute to arbitration.

Accordingly, the Court will issue a preliminary injunction prohibiting consummation of the Purchase Agreement. That injunction, however, will expire, in the absence of further order, in thirty days. During this period,

[50] LLC Agreement, Section 18.2(a).

FOI may take its claims to the arbitration forum and seek interim relief there.

An order will be entered to implement this Memorandum Opinion.