

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

SOMERVILLE S TRUST,)
) C.A. No. 19446-NC
Plaintiff,)
)
v.)
)
USV PARTNERS, LLC AND USV)
MANAGEMENT, LLC,)
)
Defendants.)

MEMORANDUM OPINION

Date Submitted: May 17, 2002
Date Decided: August 2, 2002

P. Clarkson Collins, Jr. and Elizabeth A. Brown, Esquires of MORRIS JAMES HITCHENS & WILLIAMS, Wilmington, Delaware and Stanley S. Arkin, Michelle A. Rice and Alan Arkin, Esquires of ARKIN KAPLAN & COHEN LLP; New York, New York; Attorneys for Plaintiff.

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JACOBS, VICE CHANCELLOR

At issue in this action brought under 6 *Del. C.* § 18-305 is whether the plaintiff, Somerville Trust (“Somerville”), is entitled to inspect certain books and records of the defendant, USV Partners, LLC (“USV”). This is the decision of the Court after trial. For the reasons set forth in this Opinion, I conclude that Somerville is entitled to the inspection relief it seeks.

I. FACTS

The facts are as found below.

A. The Parties

The plaintiff, Somerville, is a revocable trust organized under the laws of Delaware. Somerville’s settlors and beneficiaries are Peter Ackerman (“Ackerman”) and his wife, Joann Ackerman.

The defendant, USV, is a Delaware limited liability company that is located in Washington, D.C. USV’s sole officer, director and employee is Mr. C. Gregory Earls (“Earls”). USV’s business and Earls’s home address are one and the same. The second named defendant, USV Management, LLC (“Management”), is a Delaware limited liability company that acts as the manager of USV. Earls is the sole member of Management, which has no directors, officers, or employees. Management’s business address is also

the same as Earls's home address.'

B. Somerville's Investment In USV

USV was organized in June 1998 for the purpose of holding (a) 500,000 shares of Series A Convertible Preferred Stock of U.S. Technologies, Inc. ("USXX"), (b) a warrant to purchase 500,000 shares of USXX common stock, and (c) any dividends or other proceeds received from the preferred shares and warrant.

Somerville became a member of USV in July 1998. From July 1998 through August 2001, Somerville made seventeen separate capital contributions totaling \$4,467,610 to USV, and in exchange acquired a portion of the above-described USV preferred and common shares. Before Somerville made its first investment in USV and before it made each successive capital contribution, Earls told Ackerman that that he, and another investor, Mr. Bass, would be co-investing with Somerville on a dollar-for-dollar basis. It is not disputed that Earls made those representations to Ackerman, or that those representations were false. In fact, Bass and Earls never did match Somerville's investment in USV on a dollar-for-dollar basis.

¹ Unless the context indicates otherwise, reference in this Opinion to USV will include Management as well.

C. Earls's Mismanagement Of USV

After Somerville made its initial investment in 1998, disputes arose between Somerville and the defendants (acting through Earls).

To begin with, Somerville requested copies of the completed Schedules A and B to the LLC Agreement. Earls ignored the request, however, and never forwarded the Schedules. Somerville requested the Schedules because they defined Somerville's relationship with the other members of USV. In particular, Schedule A was important to Somerville because it would list the name and address of each member, as well as the "Original Capital Contribution," the "Class Type and Class Percentage Interest" and the "Number of Units" of USV held by each member. Without that information, Somerville would be unable to determine, among other things, its percentage interest in USV as defined by Section 3.2 of the LLC Agreement.

Other, more serious, violations of the LLC Agreement by the defendants occurred during 1999. On April 1, 1999, Earls caused USV to borrow \$1,050,000 million from USXX to enable USV to acquire 3,000,000 shares of USXX common stock. USV executed a promissory note, payable on April 30, 1999, for the \$1 ,050,000 loan amount. USV also entered into a stock pledge agreement that encumbered the 3,000,000 shares as security for

the loan if USV defaulted on the note. These transactions violated Section 5.1.4(d) of the LLC Agreement, which expressly prohibited USV from borrowing those funds from USX without Somerville's and every other member's written approval. They also violated Section 5.1.4(j), which expressly prohibited USV from pledging assets without the unanimous written approval of the members - approvals that were never obtained.

In connection with USV's pledge of its USXX stock, Earls, on behalf of USV, filed a Schedule 13D with the Securities and Exchange Commission to which was appended the stock pledge agreement. That agreement, which was incorporated into the Schedule 13D, falsely represented that "no consent, approval, authorization or other order of any person is required for (i) the execution and delivery of this Agreement by Pledgor [(USV)] of the Collateral to Pledgee [(USXX)] as provided herein."²

Between August 2000 and August 2001, Earls made other false representations to Somerville, to induce it to make additional investments in USV. When Ackerman told Earls that he would not continue investing in USV unless the conversion price were reduced, Earls agreed to reduce the conversion price of Ackerman's Class D Preferred shares of USXX. On the basis of Earls's representations, Somerville made eight additional

² PX 4.

investments in USV. Earls's representation was false, and the conversion ratio was never reduced.

D. Other Mismanagement By Earls

In mid-2000, Earls agreed to become the syndicate manager for a round of financing (the "B Round") for Fresh Direct, an online grocery business founded and funded primarily by Ackerman. As syndicate manager, Earls's responsibility was to identify and solicit funds from potential investors. After Earls identified a potential investor for Fresh Direct and obtained a binding commitment, that investor would enter into an agreement that obligated Earls to act as a nominee with respect to the investment. The investor would then transmit its investment funds to (what the investor was told) was an escrow account established by Earls for Fresh Direct. In fact, however, Earls never established an escrow account. Nor did he segregate Fresh Direct investor funds. Instead, Earls commingled Fresh Direct funds with wholly unrelated USXX interest bearing funds, in an investment account of which Earls was a signatory.

In September 2001, a company called CIBC agreed to invest in the B Round. CIBC transmitted \$1.5 million by wire transfer to the USXX investment account controlled by Earls. As earlier stated, the CIBC funds

were not segregated from funds that were unrelated to the Fresh Direct investment.

in anticipation of the closing of the B Round, CIBC directed Earls to transfer its \$1.5 million investment by wire to Fresh Direct on October 24, 2001. Earls did not honor CIBC's wire transfer instructions. The following day, CIBC and Ackerman protested Earls's failure to transmit the Fresh Direct funds. Earls apologized, claiming that there had been a mistake. When the funds had not been received by the following Monday (October 29), Ackerman's controller contacted the bank where the USXX investment account was held and discovered that Earls had never made any wire transfer request.

Later that day, Fresh Direct received what it initially was led to believe were the CIBC funds. In fact, however, and as Ackerman later learned, CIBC funds actually belonged to Apogee Fund, L.P. ("Apogee"), whose president, Emmet Murphy, had expressed to Earls an interest in investing in Fresh Direct. Earls admits that he received Apogee's funds, but claims that Murphy no longer wanted to invest in Fresh Direct, so the Apogee funds were not invested. Murphy, however, denies having directed Earls to return his investment in Fresh Direct. At this stage, the status of the Fresh Direct investment, or who owns what interest in that company, is not

clear. Nor is it clear where the funds invested by CIBC (or **Apogee**) are presently situated.

By this time, Ackerman had become concerned about Earls's integrity, and commenced an investigation of Earls and his conduct at USV. During the course of that investigation, Ackerman first learned about USV's debt to USXX and the stock pledge agreement, neither of which (to reiterate) had been approved by the members as required by the LLC Agreement.

**E. Somerville Demands Inspection
Of USV's Books And Records**

As a result of its investigation, Somerville concluded that USV had been mismanaged, and that it may have been used as a vehicle to perpetrate a fraud on USV's members. By letters dated January 30, 2002 and February 6, 2002, Somerville made a formal demand to inspect the books and records of USV under both the LLC Agreement and Section 18-1 305 of the Delaware Limited Liability Company Act. To date, Somerville has received only a small fraction of the documents it has requested.

On April 8, 2002, Earls dissolved USV by sending a "notice of involuntary withdrawal" to Somerville and all other Class A members. According to counsel, the effect of that notice is to deprive Somerville of its status as a Class A member of USV. In connection with that "notice," Earls has purported to return the USXX shares owned by Somerville to

Somerville, but the parties dispute the number of shares that Somerville actually owns and that are due to it.”

II. THE ISSUES AND CONTENTIONS

Somerville, as a USV member, requests inspection of USV’s books and records for two separate purposes: (i) to investigate allegations of wrongdoing and mismanagement of USV by Earls, and (ii) to value its (Somerville’s) membership interest in USV. The defendants agree that Somerville’s stated purposes are proper as a purely legal matter, but they nonetheless challenge Somerville’s inspection demand on two separate grounds.

The first challenge attacks the factual *bona fides* of the stated purpose of investigating mismanagement. The defendants argue that even if Earls did engage in wrongful conduct during his management of USV, Somerville has not presented any credible evidence that that mismanagement adversely affected Somerville’s interests as a USV member. Stated differently, the defendants’ argument is that Somerville’s first stated purpose is factually groundless, because that purpose is not in fact “reasonably related to the member’s interest as a member of the limited liability company” as 6 *Del.*

³ Somerville is currently in possession of 18,754,873 of the 19,043,190 USXX Class A shares that it claims it owns and is due **from** USV.

C. § 18-305(a) requires. Instead (defendants argue), Somerville seeks to inspect USV's books and records to serve some unspecified interest that is unrelated to its status as a member of USV.

Second, the defendants argue that while valuing a member's interest in an LLC may be a proper purpose for a books and records inspection, in this case no inspection is needed for Somerville to value its membership interest, because USV's sole purpose has always been to hold its members' USXX stock. Because Somerville knows the exact amount of USXX stock it holds, (the argument goes), perforce Somerville must know the value of its membership interest in USV.

For the reasons next discussed, I conclude that both of these objections to Somerville's inspection request are without merit.

III. ANALYSIS

A. **The Propriety Of Somerville's Stated Purpose To Inspect USV's Books And Records**

1. Introduction

Somerville contends that under 6 *Del. C.* § 18-305, it has a statutory right to inspect USV's books and records. That Section provides that:

(a) Each member of a limited liability company has the right. . . to obtain from the limited liability company from time to time upon reasonable demand for any purpose reasonably related to the member's interest as a member of the limited liability company:

- (1) True and full information regarding the status of the business and financial condition of the limited liability company;
- (2) Promptly after becoming available, a copy of the limited liability company's federal, state and local income tax returns for each year;
- (3) A current list of the name and last known business, residence or mailing address of each member and manager;
- (4) A copy of any written limited liability company agreement and certificate of formation and all amendments thereto, together with executed copies of any written powers of attorney pursuant to which the limited liability company agreement and any certificate and all amendments thereto have been executed;
- (5) True and full information regarding the amount of cash and a description and statement of the agreed value of any other property or services contributed by each member and which each member has agreed to contribute in the future, and the date on which each became a member; and
- (6) Other information regarding the affairs of the limited liability company as is just and reasonable.

The case law interpreting Section 18-305 holds that for inspection relief to be granted, the plaintiff must first establish by a preponderance of the evidence the existence of a “proper purpose” for inspection.⁴ A proper

⁴ *Sec. First Corp. v. U.S. Die Casting & Dev. Co.*, 687 A.2d 563, 567 (Del. 1997); *Saito v. McKesson HBOC, Inc.*, 2001 WL 8 18 173, at *4 (Del. Ch. July 10, 2001), *aff'd in relevant part*, 2002 WL 1302958 (Del. Supr. June 11, 2002). Because of a lack of reported decisions in the LLC context, the Court may look to cases interpreting similar Delaware statutes concerning corporations and partnerships. *See, e.g., Bond Purchase, L.L.C. v. Patriot Tax Credit Props., L.P.*, 746 A.2d 842, 85 1 (Del. Ch. 1999).

purpose is one that is “reasonably related to such person’s interest” as a member, limited partner or stockholder.⁵ Once a member demonstrates that its primary purpose is proper, any secondary purpose, whether proper or improper, is irrelevant.⁶ It is undisputed that both of Somerville’s stated purposes are proper as a matter of Delaware law.⁷

The issue presented is whether Somerville’s stated purpose is reasonably related to its interest as a member of USV. The evidence shows that it is. In an earlier Opinion, this Court concluded that Somerville had shown “at least prima facie a pattern of misrepresentations by Earls, a pattern that may rise to the level of criminal conduct.” At trial, the defendants offered nothing to rebut the plaintiffs prima facie case. Indeed, the overwhelming weight of the evidence establishes a credible basis to believe that Earls mismanaged USV in several different respects that would

⁵ *Saito*, 2001 WL 8 18 173 at *4 (citations omitted).

⁶ *Thomas & Betts Corp. v. Leviton Mfg. Co.*, 681 A.2d 1026, 1030 n.1 (Del. 1996) (citations omitted).

⁷ See, e.g., *Dobler v. Montgomery Cellular Holding Co.*, 2001 WL 1334182, at *3 (Del. Ch. Oct. 19, 2001) (“[A] stockholder may demonstrate a proper demand for the production of corporate books and records upon a showing, by a preponderance of the evidence, that there exists a credible basis to find probable corporate wrongdoing.”); *Macklowe v. Planet Hollywood, Inc.*, 1994 WL 560804, at *4 (Del. Ch. Sept. 29, 1994) (holding that valuing a stockholder’s shares “is clearly related to [the plaintiffs] interest as a shareholder”).

⁸ Ruling, dated April 18, 2002 at 5:14-5:16.

adversely effect Somerville's economic interest as a member of USV. My reasons follow.

2. The Purpose Of Investigating Mismanagement

a. *Earls Fraudulently Induced
Somerville To Invest in USV*

Somerville's first claim of mismanagement is that it was fraudulently induced to invest in USV in that, among other things, Earls falsely represented (as the managing member of USV) to Somerville that he, along with Bass, would be co-investing with Somerville in USV on a dollar-for-dollar basis.⁹ Because USV was formed to acquire a sizeable portion of USXX's equity, and thereby influence the management of USXX, it was material to Somerville that Earls and Bass would be co-investing with Somerville. The larger the aggregate investment in USV, the greater would be USV's equity stake in USXX. The record establishes that without Earls's (false) representations as to the amount of USXX equity that USV would acquire (by reason of Earls's and Bass's co-investments), Somerville would not have invested in USV.

Earls does not seriously dispute that he represented to Somerville (through Ackerman) that he would be co-investing with Somerville. Earls

'Ackerman Dep. 95:13-99:13; 117:18-178:7.

also admits that he never honored that promise.” Accordingly, I find that the plaintiff has shown credible evidence that Earls fraudulently induced Somerville to invest in USV.¹¹

b. *US V Improperly Incurred
Indebtedness And Pledged Assets*

Somerville next contends, and the record evidence further demonstrates, that the defendants violated the terms of the LLC Agreement by incurring debt on USV’s behalf and by pledging USV’s assets to secure that indebtedness, without obtaining the requisite unanimous approval of its members.

Section 5.1.4 of the LLC Agreement provides that:

The following actions by the Manager *shall require the written approval of the Members holding all of the Percentage Interests:* . . . (d) to assume, endorse, provide collateral for, incur or guarantee, act as surety for, or become liable for any indebtedness for borrowed money on behalf of the Company; . . . (j) to give, grant or enter into any options or sale contracts,

¹⁰ Earls’s only defense appears to be that Ackerman should have known that Earls’s representations were not true, because Earls told Ackerman that he was having liquidity problems. At no time, however, did Earls tell Somerville that he and Bass would not be co-investing on a *pari passu* basis with Somerville.

¹¹ There is credible evidence that Somerville was also induced to make additional investments in USV by what appear to be false representations made by Earls with respect to the value of USXX’s assets and the occurrence of certain corporate events within USXX that would have generated significant profits for USV. Ackerman Dep. 81:8-81:19;100:11-105:11. In addition, Earls may have misrepresented the amount of cash that USXX had. Ackerman Dep. 107:17-117:19.

mortgages, liens, other encumbrances or pledges on or with respect to the Property.”

It is undisputed that the defendants never obtained the written approval of Somerville or of the other USV members as the LLC Agreement required.¹³ Despite that, Earls caused USV to incur \$1,050,000 of debt, and he also caused it to pledge 3,000,000 shares of USXX common stock (which had been purchased with the loan proceeds) as collateral for that note, all in violation of the LLC Agreement. Thus, on this claim as well I find that USV has established by a preponderance of credible evidence, issues of possible mismanagement of USV by Earls.

c. *Earls Caused A False USV Schedule 13D To Be Filed With The SEC*

Somerville further claims, and the evidence shows, that in April 1999, USV filed a Schedule 13D with the SEC that contained material misstatements; the filing was signed by Earls, who was acting in his capacity as the sole member of the management of USV.¹⁴ The Schedule 13D stated, in part, that

¹² LLC Agreement § 5.14 (emphasis added).

¹³ Lerner Dep. 138:3-136:21-183:10-185:3; Earls Dep. 67:22-69:9. In addition, Earls admits that USV advanced money to USXX. PX 30 (Earls Dep. Errata Sheet). Again, because Somerville’s written consent was not first obtained, that advance violated Section 5.1.4 of the LLC Agreement.

¹⁴ PX 4.

[t]o guarantee its obligations under the promissory note, USV Partners, LLC pledged the 3,000,000 shares of Common Stock to [USXX] pursuant to a Stock Pledge Agreement of USV Partners, LLC dated April 1, 1999, which agreement is attached hereto as Exhibit A and incorporated by reference into this Amendment No. 2 to Schedule 13D (the “Stock Pledge Agreement”).”

The Stock Pledge Agreement referenced in the Schedule 13D stated that:

*[n]o consent, approval, authorization or other order of any person is required for (i) the execution and delivery of this Agreement by Pledgor or the delivery by Pledgor of the Collateral to Pledgee provided herein.*¹⁶

Clearly, this representation in USV’s Schedule 13D was false.

Although this Court cannot (and does not purport to) determine whether USV’s false disclosures violated federal securities law,” it can (and does) conclude that those disclosures constitute additional credible evidence of possible wrongdoing and mismanagement at USV under Delaware law.¹⁸

¹⁵ *Id.*

¹⁶ *Id.* (emphasis added).

¹⁷ Section 28 of the Securities Exchange Act of 1934 (15 *U.S.C.A.* § 78bb) vests exclusive jurisdiction in the federal courts to determine claims that the 1934 Act was violated in actions brought to enforce that Act.

¹⁸ The defendants do not dispute that the representations in the Schedule 13D were false. Rather, they argue that the plaintiff has not shown why such a statement was materially misleading, or how Somerville’s interest was adversely affected by the statement. That argument misapprehends Somerville’s burden under the “purpose” prong of a books and records analysis, however. Somerville need show only (by a preponderance of) credible evidence that wrongdoing may have occurred at USV, not that Somerville’s specific interest in the LLC was adversely affected by the misstatement. *See Sec. First Corp. v. U.S. Die Casting & Dev. Co.*, 687 A.2d 563, 565 (Del. 1997)

*d. The Defendants Did Not Operate USV
In Accordance With The LLC Agreement*

Somerville next points to instances where Earls, as USV's manager, violated other obligations imposed by the LLC Agreement. More specifically, that Agreement required the defendants to provide Somerville with a completed Schedule A and Schedule B. Those Schedules were to set forth the names and percentage interests of the other Class A and B members.¹⁹ Those Schedules were never provided to Somerville. Nor have the defendants provided USV's annual financial statements, as the LLC Agreement required.²⁰

Earls admits that USV did not provide Somerville with the completed Schedules or the financial statements,²¹ and he makes no effort to explain his failure to do so. Instead, Earls argues that that information is not "essential or sufficient" to value its interest in USV or to investigate possible wrongdoing, because Somerville knows precisely how many shares of USXX it owns. That argument misses the point. Somerville is contending

(holding that a plaintiff must establish by a preponderance of the evidence a credible showing that there are legitimate issues of wrongdoing).

¹⁹ LLC Agreement §§ 3.1-3.4. The members' lists are essential for Somerville to determine its percentage interest in USV, and whether the shares of USXX have been properly allocated to Somerville. LLC Agreement § 3.3.

²⁰ LLC Agreement § 8.2.

²¹ Earls Dep. 37:6-45:14.

that the defendants may have issued more common and/or preferred shares than were authorized, in which case Somerville was never issued its proper allotment of USXX shares. The defendants' refusal to abide by the bedrock disclosure requirements of the LLC Agreement is, in and of itself, credible evidence of mismanagement by Earls of USV and of wrongful conduct.

e. *Earls Has Engaged In A Pattern Of Similar Misconduct In Other Single-Purpose Entities*

Somerville also contends that there is credible evidence that Earls has exhibited a pattern of defrauding investors in single-purpose entities controlled by him, and that Earls's past misconduct provides a credible basis to conclude that he may have mismanaged USV as well. I agree.

Earls has been sued numerous times by investors who complained of his management of single-purpose entities other than USV.²² In one case, an arbitration panel found that Earls had commingled LLC's and personal assets, had pledged LLC assets for his own personal indebtedness, and had otherwise engaged in wrongful conduct.²³ In an earlier Ruling, this Court, alluding to the previous lawsuits against Earls, stated that "there is a pattern that may rise to the level of criminal conduct, in a series of cases that

²² See, e.g., *Finland v. Earls*, C.A. No. 01-424-A (E.D. Va. 2001); *Prince v. Earls*, C.A. No. 00 ca 05 191-00 (D.C. Super. Ct. 2000); *Marcus v. Earls*, C.A. No. 1 :00CV02859 (D. D.C. 2000).

²³ PX 9 (*Eagles v. Earls*, Arbitration No. 16 18 1 00166 99 (Dec. 8, 2000)).

involved [Earls] inducing investors to invest their moneys and then proceeding to divert those moneys to himself, resisting any efforts by the investors to enforce their rights until he had no choice but to settle.”²⁴ Since that Opinion was issued, Earls has been sued twice more by investors in companies, other than USV, who allege that they were defrauded by him.²⁵

Although claims of wrongful conduct in unrelated cases certainly do not establish that Earls mismanaged USV, the ever-increasing pattern of fraud claims against Earls (which are similar to the claims of wrongdoing made by Somerville here) lend further credibility to the other evidence that does tend to establish that Earls has mismanaged USV.

*f. Earls Disregard Legal Formalities
When Operating And Managing USV*

Somerville next claims that Earls mismanaged USV by not observing legal formalities while operating the business. In effect, Somerville argues, Earls used USV as his alter ego. The defendants make no effort to rebut that claim, and I find independently that Somerville’s evidence supporting that claim is credible.

²⁴ Ruling, dated April 18, 2002, at 5: 14-5: 18.

²⁵ PX 40, 43.

Earls testified that USV had no officers, directors, or employees, that USV had no office, and that USV's address was Earls's home address."²⁶ Moreover, USV's documents were kept at USXX's office, at Earls's personal accountant's office, and at his home.²⁷

In a previous arbitration proceeding brought against Earls for his management of an unrelated single-purpose entity, the arbitrators found that there, as here, Earls was the "sole shareholder, director, officer, and decision-maker of the PC, which has no office or employees. Either Earls or his accountant maintains PC's books and records and its mailing address is that of Earls's office or residence."²⁸ In that case, the arbitration panel also found (as Somerville claims here) that Earls had improperly used the entity's assets to secure debts, which the panel characterized as a "pervasive disregard of corporate formalities, all of which is probative in supporting the conclusion that the LLC, PC, and the Trust were in fact merely alter egos of Earls."²⁹

²⁶ Earls Dep. 9:19-12:17; 14:7-15:15.

²⁷ *Id.* at 9:19-10:12.

²⁸ PX 9.

²⁹ *Id.*

In summary, the preponderance of the evidence supports Somerville's stated purpose of investigating possible mismanagement.

3. The Purpose Of Valuing
Somerville's Interest In USV

Somerville's second stated purpose for seeking an inspection of USV's books and records is to value its interest in USV. It is undisputed that valuing a member's interest is a proper purpose under Delaware law.³⁰ The parties also agree that the defendants have provided no financial information to Somerville relating to the value of USV or of Somerville's interest in USV.

The defendants argue that despite the LLC Agreement's requirement that annual financial statements be given to the members,³¹ Somerville does not need any financial information, because it is able to value its interest with the information it already has, namely, the USXX stock subscription agreements. That argument is utterly without merit.

The defendants concede that they and Somerville dispute the number of USXX Class A shares that Somerville owns. Moreover, the defendants and Somerville disagree over what number of Class F Preferred shares

³⁰ *Macklowe v. Planet Hollywood, Inc.*, 1994 WL 560804, at *4 (Del. Ch. Sept. 21, 1994); *Ostrow v. Bonney Forge Corp.*, 1994 WL 114807, at *7 (Del. Ch. Apr. 6, 1994).

³¹ LLC Agreement § 8.2.

Somerville acquired with its \$78,100 investment. The defendants claim that Somerville owns 788.1 shares, which would indicate a per-share price of \$1000. Somerville's subscription agreement, however, states that the per-share price was to be \$150, in which case Somerville would own over 5,000 Class F shares. Clearly, then, Somerville cannot value its interest in USV solely by reference to the subscription agreements alone, and is entitled to additional information, derived from USV's books and records, that will enable it to value its interests in USV.

Having determined that Somerville is entitled to USV's books and records, I turn to the scope of the relief to be granted.

B. The Scope Of The Inspection Relief

In addition to showing a proper purpose, Somerville must also show that the documents that it seeks are "essential and sufficient" for those purposes.³² For the reasons that follow, I find that Somerville has made the required showing.

1. Capital Account Balances

Somerville seeks to inspect documents that reflect USV's capital account balances for all its members since June 1998, when Somerville

³² *Thomas & Betts Corp. v. Leviton Mfg. Co.*, 68 1 A.2d 1026, 1034 (Del. 1996); see also *Magid v. Acceptance Ins. Cos.*, 2001 WL 1497177, at *6 (Del. Ch. Nov. 15, 2001).

became a USV member. In opposition, the defendants reiterate **their** often-used argument that USV is merely a pass-through entity, and that all of the members' invested funds were used to buy USXX shares. Therefore (the argument goes), because all its funds were used to buy USV shares, Somerville knows its own capital account balance. The defendants' contention misses the point. As previously discussed (at pages 3-4, 13-14 *supra*), the evidence shows that Earls caused USV to engage in transactions that were violative of the LLC Agreement, including incurring debt and making loans without the unanimous written consent of the members. Had USV truly been operated as a pass-through entity with all the members' funds being used to purchase USXX shares, there would have been no reason for USV to become indebted to USXX. In addition, the defendants concede that the number of shares that Somerville owns is in dispute. It follows that the capital account balances must also be in dispute.

Moreover, and in any event, USV is obligated under the LLC Agreement to provide the requested documents relating to the capital account balances.³³

³³ LLC Agreement §§ 3.5, 8.2; 6 Del. C. § 18-305(a)(5).

2. Subscription Agreements

Somerville also seeks, and I conclude that it is entitled to, the subscription agreements that USV entered into with its class A and B members. The plaintiff has presented credible evidence that (i) Earls has misappropriated investor funds for his own personal benefit in the past; (ii) Earls sold to Apogee a bogus investment in Fresh Direct; and (iii) the defendants and Earls caused USV to engage in a series of improper transactions-including making loans to USXX with member funds and improperly pledging USV assets. Somerville has satisfied me that the only way it can accurately determine USV's actual capital account balance (and whether Earls has misused investor funds), as well as Somerville's percentage interest of that capital account balance, is by inspecting the subscription agreements of all of the members who hold Class A and B shares of USV.

3. Promissory Notes And Pledge-Type Documents

Any loans or pledges made without Somerville's consent are in clear violation of the LLC Agreement. The defendants claim that they are willing to produce the USV pledge and loan information,³⁴ but to date, no such

³⁴ Defs. Pre-Trial Br. at 25.

documents have been provided. The defendants will be ordered to produce those documents forthwith.

4. Documents Showing When USXX Shares Were Acquired

Somerville also seeks to inspect documents that evidence when USXX shares were acquired, to determine (among other things) whether Earls used Somerville's and other members' funds for his own personal benefit. Specifically, the plaintiff contends that Earls may have delayed in purchasing USXX shares with member funds, because he temporarily diverted those funds for his personal use. Earls has a demonstrated pattern of treating investor funds as his own, and Somerville has presented credible evidence that the funds it transferred to USV were not immediately used to purchase USXX shares. The defendants resist Somerville's request, arguing that it does not matter whether Earls used members' funds, so long as in the end, Somerville wound up with the shares for which it subscribed. The argument lacks merit, because a fiduciary's diversion of corporate funds for personal use, even if temporary, still evidences mismanagement.

In any event, the defendants' argument fails because the parties dispute whether Somerville received all of its subscribed-for shares. Somerville is entitled to inspect books and records that would establish that fact one way or another. Accordingly, the Court concludes that Somerville

is entitled to inspect the documents showing when the USV members' USXX shares were acquired by USV.

5. Fund Transfer Information

Somerville has demonstrated, and the defendants have confirmed, that there is a capital imbalance at USV. Accordingly, Somerville, as a member of USV, is entitled to inspect the USV records that would show the precise amount of funds, transferred from USV, that created the capital imbalance.³⁵

6. USV Tax Documents

Without viewing the various USV tax returns for the relevant period, it is not possible for Somerville to ascertain whether USV filed accurate tax returns and whether USV reported any losses. Earls has been accused of filing false tax returns in the past. Given the scope of the claimed wrongdoing at USV, Somerville's need to inspect the tax returns is reasonable. Stated more precisely, the tax returns are essential and sufficient for Somerville's purposes for seeking inspection.

7. Other Business And Financial Information

Section 8.2 of the LLC Agreement obligates USV to provide Somerville with audited and unaudited financial statements and balance

³⁵ Likewise, Somerville is entitled also to any documents pertaining to loan and fund transfers by USV (document request G).

sheets. Somerville has inexcusably never been provided with that information. Those financial statements must also be produced forthwith.

8. Funds Used To Acquire Class B Interests

Earls testified that he and entities solely controlled by him own the Class B units of USV.³⁶ It is not clear where Earls acquired the funds to purchase his Class B interest, and Somerville believes that that interest may have been wrongfully acquired with funds invested by the members. The scope of Somerville's demand for these documents is not clear. Insofar as Somerville seeks Earls's personal financial statements or the financial statements of other entities controlled by him, Somerville's request will be denied. Somerville will, however, be granted inspection of the records of USV that relate to any transfer of USV members' funds to Earls that may have been used for the purpose of purchasing Earls's Class B interest.

9. USV Members' List

The LLC Agreement plainly mandates that Somerville be provided with USV's member list.³⁷ The defendants offer no credible explanation

³⁶ Earls Dep. 56:4-56:6.

³⁷ LLC Agreement §§ 3.2, 3.4, 6.3.1; see *also* 6 *Del. C.* § 18-305(a)(3) (providing that an LLC member is entitled to “[a] current list of the name and last known business, residence or mailing address of each member or manager”).

why, given that mandate, Somerville is not entitled to the lists. Accordingly, the defendants will also be ordered to turn over those lists to Somerville.

IV. CONCLUSION

For the reasons set forth above, I find that the plaintiff has established proper purposes for its demands and that the inspection of the requested books and records is essential and sufficient for those purposes. Counsel shall confer and submit an implementing order reflecting the rulings in this Opinion.