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

LESLIE P. MORGAN and THEODORE S. MORGAN,	)	
Plaintiffs,	)	
v.	)	C.A. No. 20430
JOSEPH A. GRACE, JR., 4000 ASSOCIATES, L.L.C., a Delaware limited liability company, and GRAMOR, L.L.C., a Delaware limited liability company,	)	
Defendants.	)	

MEMORANDUM OPINION

Submitted: October 6, 2003
Decided: October 29, 2003

Richard M. Beck, Esquire, Denise S. Kraft, Esquire, KLEHR, HARRISON, HARVEY, BRANZBURG & ELLERS LLP, Wilmington, Delaware, *Attorneys for the Plaintiffs.*

James F. Kipp, Esquire, TRZUSKOWSKI, KIPP & KELLEHER, Wilmington, Delaware; D. G. Rassias, Esquire, ELLIOTT REIHNER SIEDZIKOWSKI & EGAN, P.C., Blue Bell, Pennsylvania, *Attorneys for the Defendants.*

LAMB, Vice Chancellor.

I.

The parties to this are the members of two Delaware limited liability companies, entities authorized pursuant to 6 *Del. C.* § 18-101, *et seq.*, and the entities themselves. The plaintiffs are Leslie P. Morgan ("L. Morgan") and Theodore S. Morgan ("T. Morgan"). The defendants are Joseph A. Grace, Jr., 4000 Associates, L.L.C., and Gramor, L.L.C.

On July 15, 2003, the plaintiffs filed this action pursuant to 6 *Del. C.* § 18-111,[1] asking the court to determine that in accordance with their agreements with the defendants, they are each entitled to the advancement of legal fees in connection with a pending civil action in the Superior Court of Delaware.[2] Defendants argue that the plaintiffs are not entitled to advancement and/or indemnification of legal expenses because the very conduct at issue in the civil action is expressly precluded from indemnification in the agreements.[3]

---

[1] Under § 18-111, "Any action to interpret, apply or enforce the provisions of a limited liability company agreement … may be brought in the Court of Chancery."

[2] On May 29, 2003, the plaintiffs were named as defendants in a civil action brought by Grace, 4000 Associates, and Gramor in the Superior Court of Delaware. *Grace, et al. v. Morgan, et al.*, C.A. No. 03C-05-260. The defendants assert a claim for breach of fiduciary duty against L. Morgan, and claims for fraud, unjust enrichment, and breach of contract against both L. Morgan and T. Morgan.

[3] It should be noted that although the defendants filed and fully briefed a motion to dismiss, the motion was withdrawn on September 22, 2003.

The court granted the plaintiffs' motion for expedited proceedings on August 13, 2003, and heard argument on the plaintiffs' motion for summary judgment on October 6, 2003. The court is persuaded that the plaintiffs are entitled to the advancement of legal fees, but only pursuant to the 4000 Associates operating agreement. The Gramor operating agreement does not provide for the advancement of legal expenses. Additionally, the court is not willing to conclude that Grace is personally liable for the advancement of legal fees. Therefore, the plaintiffs are entitled to the advancement of legal fees from 4000 Associates, and their motion for summary judgment will be granted in part.

II.

Pursuant to Court of Chancery Rule 56, a motion for summary judgment should be granted where there are no genuine issues of material fact and the moving party is entitled to judgment as a matter of law.[4] In deciding a motion for summary judgment, the facts must be viewed in the light most favorable to the non-moving party and the moving party has the burden of demonstrating that there is no material question of fact.[5] Summary judgment is an effective vehicle for deciding the advancement of legal fees "as the relevant question turns on the

---

[4] *Haas v. Indian River Volunteer Fire Co.*, 2000 WL 1336730, at *3, (Del. Ch. Aug. 14, 2000), *aff'd*, 768 A.2d. 469 (Del. 2001). *See, e.g., Williams v. Geier*, 671 A.2d 1368, 1375 (Del. 1996).

application of the terms of the corporate instruments setting forth the purported right to advancement and the pleadings in the proceedings for which advancement is sought."[6] The value of the right to advancement is that it is granted or denied while the underlying action is pending. The advancement of legal fees should be seen as a decision to advance credit and does not in any way affect the underlying action.[7]

III.

4000 Associates and Gramor were formed to purchase and develop a vacant parcel of land in Wilmington, Delaware.[8] 4000 Associates was formed on March 24, 1997, and Gramor was formed in April 2000. The plaintiffs were members of both LLCs from formation until they resigned on May 31, 2001.[9] The plaintiffs argue that they are entitled to advancement and/or indemnification of legal fees pursuant to specific provisions in their agreements with the defendants.

A. The 4000 Associates Operating Agreement

---

[5] *Tanzer v. Int'l Gen. Inds., Inc.*, 402 A.2d 382, 385 (Del. Ch. 1979) (citing *Judah v. Delaware Trust Co.*, 378 A.2d 624, 632 (Del. 1977)).

[6] *Weinstock v. Lazard Debt Recovery GP, LLC*, 2003 WL 21843254, at *2, (Del. Ch. Aug. 1, 2003).

[7] *Advanced Mining Sys., Inc. v. Fricke*, 623 A.2d 82, 84 (Del. Ch. 1992).

[8] The original business deal involved the purchase of a Holiday Inn and the adjacent vacant lot.

[9] L. Morgan was also involved in the management of Gramor and 4000 Associates during her time with both entities.

The plaintiffs point to various sections of the 4000 Associates operating agreement as imposing a mandatory obligation to advance legal fees on both the entity and Grace, personally. Section 12.4 and 12.5 address the LLC's obligations concerning indemnification and advancement of legal fees, while section 17.10 assigns personal liability for indemnification.

1. The Obligations Of The LLC To Indemnify And Advance Fees

The 4000 Associates operating agreement deals with advancement and indemnification in two distinct sections. Section 12.4 addresses indemnification and does not speak to the advancement of fees.[10] Section 12.5 sets out the company's procedure on the advancement of legal fees. The provision reads:

> Section 12.5 Expenses. *To the fullest extent permitted by applicable law,* expenses (*including legal fees)* incurred by a Covered Person in defending any claim, demand, action, suit or proceeding shall, from time to time, be advanced by the Company prior to the final disposition of such claim, demand, action, suit or proceeding upon receipt by the Company of an undertaking by or on behalf of the Covered Person to repay such amount if it shall be determined that the

[10] That section states: "12.4 Indemnification. *To the fullest extent permitted by applicable law,* a Covered Person shall be entitled to indemnification from the Company for any loss, damage or claim incurred by such Covered Person by reason of any act or omission performed or admitted by such Covered Person in good faith on behalf of the Company and in a manner reasonably believed to be within the scope of authority conferred on such Covered Person by the Agreement, except that no Covered Person shall be entitled to be indemnified in respect of any loss, damage or claim incurred by such Covered Person by reason of gross negligence or willful conduct with respect to such acts or omissions; provided however, that any indemnity under this Section 12.4 shall be provided out of and to the extent of Company assets only, and no Covered Person shall have any personal liability on account thereof" (emphasis added).

> Covered Person is not entitled to be indemnified as authorized in Section 12.4 hereof.[11]

Both sections provide that the company is required to indemnify and advance legal fees if the Limited Liability Company Act ("LLCA") would allow it to do so. Section 18-108 of the LLCA provides limited liability companies with the broad statutory authority to indemnify their members and officers, as follows:

> Subject to such standards and restrictions, if any, as are set forth in its limited liability company agreement, a limited liability company may, and *shall have the power to, indemnify and hold harmless any member or manager or other person from and against any and all claims and demands whatsoever*.[12]

Since the statute is broadly enabling[13] and the provisions of the operating agreement are clear and unambiguous, the court must honor the intent of the parties in interpreting their contract.[14]

---

[11] Emphasis added.

[12] Emphasis added.

[13] In fact, § 18-108 of LLCA is verbatim § 17-108 of the Delaware Revised Uniform Limited Partnership Act ("DRULPA"). Both DRULPA and LLCA allow the contracting parties to determine the extent of indemnification in their agreements. In granting the advances on claims of indemnification in a limited partnership setting, former Chancellor Allen held that "courts should interpret language so as to achieve where possible the beneficial purposes that indemnification can afford." *Delphi Easter Partners Limited Partnership v. Spectacular Partners*, 1993 WL 328079, at *2, (Del. Ch. Aug. 6, 1993). *See also Nakahara v. NS 1991 American Trust,* 739 A.2d 770, 783 (Del. Ch. 1998) (discussing how the GCL is construed more strictly while statutes such as DRULPA are given more flexibility in authorizing indemnification).

[14] *See Citadel Holding Corp. v. Roven*, 603 A.2d 818, 822 (Del. 1992) (holding that an indemnity provision of an agreement will be honored using the standard concept of contract interpretation in that "[i]t is an elementary canon of contract construction that the intent of the parties must be ascertained from the language of the contract," citing *Myers v. Myers*, 408 A.2d 279 (Del. 1979); *Dupont v. Wilmington Trust Co.,* 45 A.2d 510 (Del. Ch. 1946)).

4000 Associates seeks to avoid this rather clear advancement obligation by arguing that no advancement is due because the plaintiffs would not be entitled to be indemnified if the conduct that is alleged in the Superior Court action were eventually proven to be true. This argument is fallacious because it conflates sections 12.4 (indemnification) and 12.5 (advancement) and blurs the distinct purpose of advancement provisions.[15] Under the language of section 12.5, the right to advancement arises when a "Covered Person" [16] incurs "expenses (including legal fees)" "in defending any claim, demand, action, suit or proceeding." The plaintiffs meet these criteria. Section 12.5 provides for the possibility that a "Covered Person" will not, eventually, prove to be entitled to indemnification by expressly requiring an undertaking "to repay [amounts advanced] if it shall be determined that the Covered Person is not entitled to be indemnified as authorized in section 12.4 hereof."[17] In this case, that

---

[15] The LLCA explicitly authorizes limited liability companies to indemnify " … *from and against any and all claims and demands whatsoever*." 6 *Del. C.* § 18-108 (2003) (emphasis added). Former Chancellor Allen noted that Delaware common law and public policy allow advancement pursuant to indemnification provisions agreed to by the contracting parties. *Delphi,* 1993 WL 328079, at *8.

[16] Article 1 of the 4000 Associates Company Agreement defines "Covered Person" as "a member, any Affiliate of a Member, any officers, directors, shareholders, partners, members, employees, representatives or agents of a Member's Affiliates, or any employee or agent of the Company or its Affiliates." The plaintiffs are clearly covered persons for purposes of the agreement.

[17] An undertaking as a condition for the advancement of legal fees is common corporate practice in the event that the covered person's conduct is later deemed not indemnifiable. *See*

determination can only be made after the Superior Court action has been adjudicated.[18] In the meanwhile, 4000 Associates must advance expenses to the plaintiffs subject to a suitable undertaking.

2. Personal Liability For Indemnification And/Or Advancement

The plaintiffs further rely on paragraph 17.10 of the 4000 Associates operating agreement to argue that Grace is personally liable to them for the advancement of their expenses in the Superior Court action. Section 17.10 is an unusual provision that the parties agree was meant to provide a strong disincentive for litigation among members over company affairs. The section reads:

> Section 17.10 Attorneys Fees. Except as otherwise provided by law, all attorneys' fees and costs incurred in connection with the prosecution and defense of any action brought by a Member against another Member or Members or the Company shall be borne entirely by such Member, regardless of the outcome of any such proceeding.

---

e.g., Donald J. Wolfe, Jr., & Michael A. Pittenger, *Corporate and Commercial Practice in the Delaware Court of Chancery*, § 8.2 (2001).

[18] The defendants' argument is a common one in cases for the advancement of legal fees, and the court is sympathetic to the "admittedly maddening aspect" of advancing legal funds to a company member in his defense of alleged wrongdoings against the company. *Reddy v. Electronic Data Systems Corp.*, 2002 WL 1358761, at *5 (Del. Ch. June 18, 2002). The advancement of legal fees, however, is regularly allowed in the corporate setting independent of the underlying claim against the party seeking advancement. *See Fasciana v. Electronic Data Systems Corp.*, 829 A.2d 160, 170 (Del. Ch. 2003) (discussing how the statutory authority for indemnity and advancement of litigation expenses for corporate members is intertwined with the public policy desire to have high-quality members "willing to make socially useful decisions that involve economic risk").

The parties agreed at the hearing on the motion for summary judgment that section 17.10 was meant to tax Grace, as the plaintiff in the Superior Court action with all of the attorneys' fees and cost incurred in that litigation, regardless of the outcome.

Section 17.10 speaks to an obligation for the eventual payment of legal expenses and does not address advancement of legal fees and therefore is not facially applicable to the issue before the court.[19] Moreover, the fee shifting mechanism found in section 17.10 is expressly limited by the language "[e]xcept as otherwise provided by law." It is easy to imagine legal limitations on the obligation created by section 17.10 that depend upon the nature of the conduct involved. For example, the court presumes that the duty to pay fees and expense would not extend to a case where the defendants are shown to have engaged in intentionally fraudulent or illegal conduct.[20] Both of these factors argue against engrafting an advancement obligation onto section 17.10.

---

[19] The court notes that the arbitrator held that this provision is against the public policy of the State of Delaware. Since the provision is inapplicable to this case, the court need not resolve whether the provision is inapposite to Delaware public policy.

[20] *Cf. Mayer v. Executive Telecard, Ltd.*, 705 A.2d 220, 224 n.6 (Del. Ch. 1997) (Delaware corporation lacks the power to indemnify a party who did not act in good faith).

B. The Gramor Agreement

The indemnification agreement in the Gramor Agreement is silent on the issue of advancement. Section 2.8 reads:

> To the fullest extent permitted by law, the LLC shall indemnify and save harmless the Members from any expense, loss, or damage incurred by it by reason of (i) any act performed by them within the scope of the authority conferred upon them by this agreement, or (ii) their failure or refusal to perform any acts except those expressly required by the terms of this Agreement, or (iii) their performance or omission to perform any acts on advice of accountants or legal counsel for the LLC; provided, however, that the LLC shall have no obligation to indemnify a Member for any expense, loss, or damage incurred by the Member as a result of such Member's own willful misconduct or gross negligence or acts in violation of his or her fiduciary duties hereunder. Any indemnity under this section 2.[8] shall be provided out of and to the extent of LLC assets only, and the Members shall have no personal liability on account thereof or otherwise.

The plaintiffs ask the court to construe this section as an advancement provision because it includes the word "expense" which is also used in section 12.5 of the 4000 Associates operating agreement in dealing with advancement. Section 2.8 stands unambiguously as an indemnification provision and makes no mention of the advancement of fees, and the court is unwilling to conclude that the mere use of the word "expense" in section 2.8 can be read to support a requirement of advancement. Delaware law is well settled that the right to indemnification and

the right to advancement are distinct.[21] And, as previously addressed, in a limited liability company setting, the language of the agreement will be honored as reflecting the intent of the parties. The LLCA clearly provides broad authority for the contracting parties to include both indemnification and advancement in their agreement.[22] For whatever reason, the parties at hand chose to expressly allow advancement in the agreement of one LLC and not in the other. The court will not rewrite those agreements to provide for a right the parties clearly did not intend.

IV.

Finally, the court rejects the defendants' argument that this action is barred as the result of an arbitration decision dated August 18, 2000. Defendants allude in general terms to this arbitration but fail to provide an adequate factual or legal analysis to support the application of the doctrine of *res judicata* to bar the relitigation of any of the claims asserted in this case.[23] This failure is probably

---

[21] The advancement of legal fees does not *ipso facto* mean that the defendant companies will have to indemnify the plaintiffs. *See Advanced Mining Sys., Inc.*, 623 A.2d at 84 ("Because I consider indemnification rights and rights to advancement of possibly indemnifiable expenses to be legally quite distinct types of legal right …"); *Citadel Holding Corp.*, 603 A.2d at 822 (distinguishing right to advancement from right to indemnification).

[22] *See* 6 *Del. C.* § 18-108 (2003).

[23] The elements of *res judicata* are: (1) the prior decision-maker must have jurisdiction over the subject matter and the parties; (2) the same parties or their privies are involved in the latter proceeding; (3) the same cause of action has been brought, or the issues are the same as those raised before; (4) the issues were decided adversely to the contentions of the party (the party against whom *res judicata* is asserted); and, (5) the prior decision was a final decree. *Cooper v. Celente*, 1992 WL 240419, at *6, (Del. Super. Sep. 3, 1992), c*iting Playtex Family*

attributable to the fact that the arbitration involved a dispute between the plaintiffs and defendant Grace, on the one hand, and another now-former member of 4000 Associates and Gramor, on the other hand.[24] Thus, the cause of action in the arbitration differs substantially from the dispute between the Morgans and Grace that gives rise to the Superior Court action and, indirectly, to this claim for advancement.

V.

In conclusion, a plain language reading of section 12.5 of the 4000 Associates operating agreement provides the plaintiffs, as Covered Persons, with the right to the advancement of their reasonable expenses (including legal fees) in the pending Superior Court action and, to that extent, their motion for summary judgment against the defendant 4000 Associates is granted. The balance of the motion for summary judgment is denied. In addition, the plaintiffs are entitled to

---

Products v. St. Paul Surplus, 564 A.2d 681, 683 (Del. Super. 1989). The record before the court on this motion does not adequately address any of these elements.

[24] The arbitrator ordered that a trustee be appointed to assist the parties in carrying out the terms of their agreements, and held that the fees for the action should be borne by the parties equally. The arbitrator did not address §§ 12.4 or 12.5 of the 4000 Associates agreement, nor § 2.8 of the Gramor agreement. The arbitrator did hold that § 17.10 of the 4000 Associates agreement was against the public policy of the State of Delaware and refused to impose any personal liability.

an award of "fees on fees" to the extent they were successful in their claim to enforce a contractual right to advancement.[25]

Counsel for the plaintiffs is directed to submit a form of order within 7 days of the date hereof, on notice.

/S/ Stephen P. Lamb
Vice Chancellor

[25] *See Stifel Financial Corp. v. Cochran*, 809 A.2d 555, 561 (Del. 2002) ("allowing indemnification for the expenses incurred by a director in pursuing his indemnification rights gives recognition to the reality that the corporation itself is responsible for putting the director through the process of litigation"); *Fasciana*, 829 A.2d at 182 (holding that a corporate official is entitled to "fees on fees" in pursuing the advancement of legal expenses).