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

| | | |
|---|---|---|
| R&R CAPITAL LLC, a New York limited liability company, and FTP CAPITAL, LLC, a New York limited liability company, | ) | |
| Plaintiffs, | ) | |
| v. | ) | *Civil Action No. 3989-VCG* |
| LINDA MERRITT (a/k/a LYN MERRITT), | ) | *Appeal No. 144, 2011* |
| Defendant, | ) | |
| and | ) | |
| BUCK & DOE RUN VALLEY FARMS, LLC, a Delaware limited liability company, GRAYS FERRY PROPERTIES, LLC, a Delaware limited liability company, HOPE LAND, LLC, a Delaware limited liability company, MERRITT LAND, LLC, a Delaware limited liability company, UNIONVILLE LAND, LLC, a Delaware limited liability company, MOORE STREET, LLC, a Delaware limited liability company, PDR PROPERTIES, LLC, a Delaware limited liability company, PANDORA FARMS, LLC, a Delaware limited liability company, and PANDORA RACING, LLC, a Delaware limited liability company, | ) | |
| Nominal Defendants. | ) | |

**MEMORANDUM OPINION**

Date Submitted: March 8, 2013
Date Decided: March 15, 2013

Richard P. Rollo of RICHARDS, LAYTON & FINGER, P.A., Wilmington, Delaware; OF COUNSEL : Paul Sweeney, of CERTILMAN BALIN, ADLER & HYMAN, LLP, East Meadow, New York, Attorneys for the Plaintiffs.

Eric Grandell, of Wilmington, Delaware; OF COUNSEL: Thomas D. Schneider, of Wallingford, Pennsylvania, Attorneys for the Defendant.

Kurt M. Heyman, of PROCTOR HEYMAN LLP, Wilmington, Delaware, Independent Receiver of the Nominal Defendants.

GLASSCOCK, Vice Chancellor

## I. SUMMARY

This case was decided by former Chancellor Chandler by Order of February 21, 2011. The Defendant, Linda Merritt, appealed. By Order of January 14, 2013, the Supreme Court, while retaining jurisdiction, directed me to address a narrow issue decided by the trial court. Specifically, I have been instructed to answer the following question: "Is the trial court's decision to defer ruling on the advancement of attorneys' fees supportable? Whether it is or not, please explain the basis for your decision."[1] I answer that question in the affirmative, as follows.

## II. BACKGROUND FACTS

Five years ago, Chancellor Chandler called the procedural history of this case a "veritable nightmare."[2] Five years have passed since then; Chancellor Chandler has retired, and this case has been remanded to my docket. Sifting through the facts of this case, therefore, has been an exercise in reconstructing another man's nightmare. I will limit my discussion of the facts to those relevant to the limited issue before me. Suffice it to say, this case has a long and complicated procedural history, involving parallel actions in both Pennsylvania and New York courts.

---

[1] *Merritt v. R&R Capital, LLC*, No. 144,2011, at 4, (Del. Jan 14, 2013)(ORDER)("Supreme Court Order").

[2] *R&R Capital, LLC v. Buck & Doe Run Valley Farms, LLC*, 2008 WL 3846318, at *2 (Del. Ch. Aug. 19, 2008)("The factual background of this dispute is somewhat predictable; the procedural background, however, is a veritable nightmare.").

In 2003, Merritt, R&R, and FTP Capital LLC formed ten Delaware limited liability companies as vehicles for investments in real estate and racehorses. In 2005, R&R filed suit in New York seeking to remove Defendant Merritt as manager of the LLCs (the "New York Action").[3] The New York court dismissed R&R's removal claim in October 2006 and the remainder of its claims in December 2007.[4] During the New York Action, the New York court ruled that Merritt was entitled to indemnification of her legal fees connected to that action.[5]

*A. The First Delaware Action*

R&R filed the first Delaware Action, seeking to dissolve the entities, in June 2008 (the "Dissolution Action").[6] On June 12, 2008, the Court entered a status quo order "to preserve the respondents' assets in case the Court ultimately ordered dissolution" (the "Dissolution Status Quo Order").[7] Between June and August 2008, both parties requested modifications to the Dissolution Status Quo Order: the Plaintiffs to strengthen the order, the Defendants to weaken it.[8] In an "emergency" motion, the Respondent LLCs requested a modification "to allow the Entities to

---

[3] Am. Compl. 4 n.2, August. 25, 2008.
[4] *Id.*
[5] Appellant's Op. Br. Ex. 3, Feb. 12, 2013.
[6] *R&R Capital*, 2008 WL 3846318, at *1. Merritt was not named as a defendant in the Dissolution Action. *Id.*
[7] *Id.* at *2.
[8] *Id. Compare R&R Capital, LLC v. Buck & Doe Run Valley Farms*, 3808-CC, Pets.' Mot Am. Status Quo Order, July 22, 2008 (requesting tighter controls on the entities' ability to transfer assets), *with R&R Capital, LLC v. Buck & Doe Run Valley Farms*, 3808-CC, Resps.' Emergency Mot. Modification Status Quo Order ¶ 4, July 3, 2008 (requesting leave to pay legal counsel).

pay counsel, and any person or entity retained by counsel, to defend themselves in this litigation . . . ."[9] This motion concerned the ability of the LLCs to pay their legal counsel, *not* Merritt's rights to indemnification or advancement. Chancellor Chandler denied that emergency motion, effectively finding it to be an emergency of the respondents' own creation, and directed the parties to promptly brief the respondents' motion to dismiss.[10]

On July 29, 2008, the New York court issued an order allowing for some of the LLCs expenses to be paid, so long as that payment did not conflict with the Court of Chancery's status quo order. On July 31, 2008, the Court held a teleconference to discuss the effect of the New York order on this Court's status quo order. Chancellor Chandler acknowledged that the respondents were caught between the rock of the New York order and the hard place of the Delaware status quo order. Nonetheless, Chancellor Chandler believed that it was possible to comply with both orders:[11]

> So you . . . can comply with his order. If you think that paying the bills that he authorized to be paid can be done and you can comply with my status quo order by simply writing checks to the veterinarians and the others that are owed, go right ahead. That's – that's your

---

[9] *R&R Capital, LLC v. Buck & Doe Run Valley Farms*, 3808-CC, Resps.' Emergency Mot. Modification Status Quo Order ¶ 4, July 3, 2008.

[10] *R&R Capital, LLC v. Buck & Doe Run Valley Farms* 8, 3808-CC, July 7, 2008 (TRANSCRIPT).

[11] Around this time, Chancellor Chandler was in contact with Judge Ramos, the presiding New York judge. *Id.* at 9. The judges appear to have been trying to work together to define the boundaries of what would and would not be heard in each court.

> choice. I'm not giving you legal advice. I'm just saying if you think you can do that and you can do it consistent with my status quo and not be in violation of it, then you should proceed with all deliberate speed to do so. . . . What I've done is enter that status quo order. If you want to challenge that, provide me with an interlocutory appeal order. I'll sign it in a heartbeat. You can go to the Delaware Supreme Court and get it reversed if you think that's the best course.[12]

Despite Chancellor Chandler's invitation to the respondents to appeal the status quo order on an interlocutory basis, no such appeal came. Instead, on August 5, 2008, the respondents renewed their request to modify the status quo order to allow for the release of $1.7 million held in escrow by a Pennsylvania court.[13] Before this motion was fully briefed and decided, Chancellor Chandler issued a memorandum opinion partially granting the respondents' motion to dismiss.[14] Chancellor Chandler found that the petitioners lacked standing to seek a dissolution of the LLCs because the parties had waived the right to request a dissolution under the LLC Operating Agreements.[15] The Dissolution Action did not end with this opinion, since some of the petitioners claims survived the motion to dismiss. Instead, the Dissolution Action continued in tandem with the Removal

---

[12] *R&R Capital, LLC v. Buck & Doe Run Valley Farms* 23:5-14, 24:7-12, 3808-CC, July 31, 2008 (TRANSCRIPT).
[13] The New York court had determined that such funds could be distributed, so long as the distribution did not violate the Delaware status quo order. *R&R Capital, LLC v. Buck & Doe Run Valley Farms* 8, 3808-CC, Mot. Am. Status Quo Order, Aug. 5, 2008.
[14] *R&R Capital*, 2008 WL 3846318, at *1.
[15] *Id.* at *1-2.

Action, which was filed the day after Chancellor Chandler issued his memorandum opinion in the Dissolution Action.

*B. The Delaware Removal Action – the Action Currently on Appeal*

On August 20, 2008, Plaintiff R&R filed a Complaint, which led to this action, seeking a declaratory judgment that Defendant Merritt was appropriately removed as manager and member of the LLCs "for cause."[16] On the same day, R&R moved for a new status quo order, which expressly bound Linda Merritt, to be entered in this Removal Action.[17] In the alternative, R&R asked for the Dissolution Status Quo Order to remain in place to prevent Merritt from dissipating the assets of the businesses.[18] On August 25, 2008, R&R amended its Complaint to add Count III, seeking a declaration that an "Event of Withdrawal" had occurred under the LLC Agreement because Merritt was bankrupt.[19] A telephone conference was held with the Court on August 28, 2008, during which R&R feared "that there is a significant risk that if funds are placed in the possession of Ms. Merritt, they will not be recoverable at a later date. And that's with respect to the new action."[20] To this, Merritt's Counsel replied:

---

[16] Compl.¶¶ 10-11, Aug. 20, 2008.
[17] Pl.'s Mot. Status Quo Order 2, Aug. 20, 2008.
[18] Letter to Chancellor Chandler from Richard P. Rollo 2, Aug. 25, 2008.
[19] Am. Compl. ¶¶ 22-25.
[20] Telephone Conference 7:13-16, Aug. 28, 2008 (TRANSCRIPT).

> [I]n the second case, if Your Honor would consider any order from the first case, we would also ask there be a carve out for the advancement of attorneys' fees. The LLC agreement is clear on Merritt, when she is sued in your her [sic] capacity, to a right of indemnification and, further, right of advancement. And therefore, as counsel for Merritt, *we will be* requesting advancement for Merritt for fees as the case proceeds.[21]

Merritt's counsel then asked the Court not to enter *any* status quo order in this action.[22] This is the first time the issue of advancement was introduced to the Court.

Following the teleconference, Merritt filed an answering brief opposing any status quo order.[23] The only mention of advancement in this brief was in a footnote at the end of the brief: "Plaintiffs cite no reason that this Court should . . . invalidate Merritt's right to advancement of fees and expenses in connection with this litigation as provided for in the operating agreements."[24] R&R filed a reply brief arguing that a status quo order was necessary to enjoin Merritt from dissipating the assets of the LLCs:

> Paragraph 10 of the Complaint lists numerous outstanding judgments against Merritt. It is readily apparent that Merritt will not be able to pay a damages award (if necessary) if she wrongfully dissipates assets of the Entities during the pendency of this action. Accordingly, a status quo order is necessary to ensure that if Merritt has been validly removed as Manger [sic], the assets of the Entities

---

[21] *Id.* at 18:20-19:4 (emphasis added).
[22] *Id.* at 24:2-6.
[23] Def.'s Resp. Pl.'s Mot. Status Quo Order 1, Sept. 3, 2008.
[24] *Id.* at 16 n.9.

> have not been transferred or otherwise been placed beyond this Court's reach. See, e.g., In re Cencom Cable Income, Pr's, L.P. Litig., 2000 Del. Ch. LEXIS 10, at *27-28 (Del. Ch. Jan. 27, 2000) (finding irreparable harm and granting injunctive relief where the partnership had a finite set of assets and there was a risk that the actions of the managing partner would deplete those assets in advance of liquidation); Brinati v. TeleSTAR, Inc., 1985 Del. Ch. LEXIS 515, at *14-16 (Del. Ch. Sept. 3, 1985) (ordering a preliminary injunction preventing the corporation from expending corporate funds outside of certain limited circumstances, where the previous rate of expenditures "raise[d] serious questions about defendants' ability to pay a damage award").[25]

However, the Plaintiff did not address the argument (to the extent it was raised) that the Defendant should be allowed to seek advancement from the funds subject to the Order in its Reply Brief.

On September 8, 2008, Chancellor Chandler entered a status quo order, without an accompanying opinion (the "Status Quo Order"). The Status Quo Order required Merritt and the entities she managed not to:

> a. enter into any agreement with respect to a merger, tender offer, restructuring or recapitalization;
> b. incur any new debt;
> c. transfer, encumber, exchange, expend, pledge, loan or otherwise dispose of, directly or indirectly, any asset;
> d. transfer, encumber, exchange, expend, pledge, loan or otherwise dispose of, directly or indirectly, any funds to Merritt, Peter Pelullo or their affiliates;
> e. engage in, enter into, or agree to any transaction, contract or agreement the value of which exceeds $1000, or any combination of transactions, contracts or agreements with an aggregate value in excess of $5,000;

[25] Pl.'s Reply Supp. Mot. Status Quo Order ¶ 32, Sept. 5, 2008.

> f. cause the dissolution, liquidation or winding up of the Entities; or
> g. institute any legal proceedings, including without limitation, any proceedings in bankruptcy.[26]

Following the entry of the Status Quo Order, the New York court entered an injunction, on October 16, 2008, enjoining the Plaintiffs in this action from interfering with Merritt's abilities to manage the LLCs.[27]

1. Merritt Moves to Stay this Action and to Modify the Status Quo Order.

There was no further action in this case until January 19, 2009, when Merritt moved to stay this action in favor of the resolution of an appeal taken in the New York action.[28] On the same day, Merritt moved to modify the Status Quo Order, specifically citing the need for advancement of her attorney's fees under the LLC Operating Agreements.[29] This is the first time Merritt formally requested a release of funds to cover her attorneys' fees; previously, her attorneys had only orally asked for a "carve out" for attorneys' fees from the Status Quo Order.[30]

On February 12, 2009, R&R moved to modify the Status Quo Order, asking for tighter restrictions to be placed on Merritt's control over the entities.[31] Specifically, R&R wished to prohibit "any action which is inconsistent with a

---

[26] Order ¶ 1, Sept. 8, 2008.
[27] *See* Letter to Chancellor Chandler from Richard P. Rollo 5-6, Jan. 30, 2009 (describing the proceedings in New York and citing to the transcript).
[28] Def.'s Mot. Stay Pending Pls.' Appeal New York Ct.'s Order 1, Jan. 19, 2009.
[29] Def.'s Mot. Modify Status Quo Order 1, Jan. 19, 2009.
[30] Teleconference 18:20-19:4, Aug. 28, 2008 (TRANSCRIPT).
[31] Pls.' Mot. Modify Status Quo Order ¶ 8, Feb. 12, 2009

winding up and liquidation of the Entities' affairs."[32] The Court held a teleconference on both motions on February 25, 2009, during which the Court agreed to stay this action based on principles of comity.[33] During the teleconference, Chancellor Chandler explained that he would forebear deciding the issue of advancement because it was "substantive":

> [S]ince Mr. Farnan has persuaded me that I should, out of respect for Justice Ramos' decision, effectively honor his injunction, it seems to me that I have to do that completely with respect to all the substantive matters that are before me, which includes the motion to modify the status quo order, the motion to pay attorneys' fees and to order advancement rights. All of those matters are substantive in nature, and to rule on those in favor of Mr. Farnan would be effectively proceeding with this litigation, which the defendants here have successfully argued before Justice Ramos should not be going forward, because it's in bad faith. And so I will formally, therefore, deny any motion to alter or modify the status quo order, or to direct the payment of any attorneys' fees or any advancement rights under the LLC agreements, because I view those as substantive decisions, that I should not consider if in fact this litigation is prosecuted in bad faith. Let me be clear on one further point, however. The fact that I am not going to modify the status quo order, and that I'm staying this litigation, does not in any way whatsoever lift or vacate the status quo order. That order remains in effect. It is a binding order of this Court. It binds the parties and it binds counsel. Until a higher authority, which in my case is the Delaware Supreme Court, reverses me, and directs me to vacate or to modify the status quo order, I view that as binding authority, and I will enforce it to the letter. If there are any violations of that order, then I expect contempt applications to be made, and we will proceed down that road, if people want to do that. I have said before, and I will repeat it again: Anyone who believes that the status quo order that I have entered is illegal or improper should

---

[32] *Id.*
[33] Teleconference 22-23, Feb. 25, 2009 (TRANSCRIPT).

> immediately apply to me for certification of an interlocutory appeal to the Delaware Supreme Court under Supreme Court Rule 42, which I will sign in two heartbeats and happily send you to the Supreme Court of Delaware to seek a reversal of my status quo order. But until then, and until it is reversed, I want everyone to understand I view it as binding authority, and nothing from any other court in any other state -- is the way I understand the law -- would change the fact that there is a binding order entered in this court.[34]

Thus, the Court was clear that (1) it had not yet decided the issue of whether Merritt was entitled to advancement and (2) Merritt remained subject to the Status Quo Order during the pendency of the stay.[35]

On March 26, 2009, Merritt moved to modify the Status Quo Order once again to allow for advancement of her legal fees.[36] Chancellor Chandler denied this request, repeating his desire to refrain from making any substantive rulings until the New York court had ruled.[37]

In April 2009, the Eastern District of Pennsylvania issued a ruling that found Merritt had defrauded R&R.[38] Although the LLC Operating Agreements expressly

---

[34] *Id.* at 24:10-26:11.
[35] *Id.*
[36] Def.'s Mot. Modify Status Quo Order 1, Mar. 26, 2009.
[37] Letter from the Court 1, Mar. 31, 2009 ("As I explained earlier, I do not intend to take any substantive actions in this case until the appeal of Justice Ramos's injunctive order has been completed. Accordingly, the provisions of my earlier status quo order remain in effect until such time as this Court changes them or until an appellate court changes them. No basis exists for modifying the status quo order at this time.").
[38] Telephonic Rulings Ct. Pets.'/Pls.' Mot. Vacate Stay, Resp./Def. Merritt's Mot. Modify Status Quo Order, Counsel for Resp./Def. Merritt's Mot. Withdraw 17:4-8, July 10, 2009 (TRANSCRIPT); Pls.' Mot. Vacate Feb. 25 Stay & Summ. J. Count I, Exs. B, C, June 30, 2009 (Opinion and Order of the Eastern District of Pennsylvania).

include fraud as a basis to remove the Manager "for cause," R&R did not, at that time, move for summary judgment, presumably because this action was stayed.

2. R&R Moves to Hold Merritt in Contempt.

On May 8, 2009, R&R moved to hold Merritt in contempt of the Status Quo Order.[39] Specifically, R&R produced evidence of Merritt's "(1) withdrawing large amounts of cash from the Entities' bank accounts; (ii) transferring funds from bank accounts belonging to the Entities to accounts belonging to Merritt and/or her affiliates (other than the Entities); and (iii) participating in an undisclosed easement transaction with certain land leased by the Entities."[40] The bank records of the LLCs revealed that Merritt had been withdrawing thousands of dollars in cash from the various LLCs every week, amounting to over $150,000 of withdrawals while Merritt was bound by the Status Quo Order.

Following the Motion for Contempt, the Court held a teleconference on May 11, 2009, during which Chancellor Chandler asked what urgency the Plaintiffs had in having the Motion for Contempt heard immediately. The Plaintiffs' counsel responded:

> The theory set forth in our most recent complaint is that *Merritt did not have the power to act as manager as of August. Whether it was retroactive or immediate, she shouldn't be spending the entity's money*. That's been clear. Your Honor told her that, what to do, yet

[39] Pl.'s Mot. Merritt's Contempt Ct.'s Feb. 25 Order & Status Quo Orders ¶ 23, May 8, 2009.
[40] *Id.*

> she continued to spend money in a manner that was inconsistent with what Your Honor said to do. Where is the urgency? The urgency is that Merritt's bills are piling up. There are judgments against her. There are other contempt motions being levied against her in other courts. The creditors are in line. We have a certain amount of money that these assets have, and we have a pecuniary interest in preserving them. We think she needs to stop spending the money, and we think she needs to return the entities to the status quo as she was ordered to do by the status quo orders. . . . The status quo orders, the irreparable harm that was the basis for the status quo order is that Merritt is likely judgment proof, and that if we ultimately get to the point of where she isn't able to -- we're correct about removing her or alternatively about the breach, if we get a monetary judgment and she fritters away the assets, it's an empty apparent victory. We're in the same position. If she is allowed to simply dissipate assets, and then at the end of the day it's found that she wasn't validly a manager and that she was removed as of August and that all of these transactions are not proper transactions, the money is gone. That irreparable harm exists today and is continuing. So I think that does create a time sensitivity to resolving her conduct or misconduct under the status quo order. [41]

The Plaintiffs' position at the telephonic hearing was that Merritt had no right to act as manager of the entities in any way, and, therefore, she was not entitled to advancement.[42]

To the allegations that Merritt was "judgment proof," Merritt's counsel responded: "What's more ironic is that they're claiming Miss Merritt is judgment proof while at the same time denying her advancement rights so she can retain paid counsel to continue to defend herself and to defend herself in light of these serious

---

[41] Pl.'s Reply Supp. Mot. Merritt's Contempt, Ex. A, Teleconference 12:20-13:13, 15:8-24, May 11, 2009 (TRANSCRIPT)(emphasis added).
[42] *See id.* at 12:21-24.

allegations."[43] Moreover, Merritt's counsel told the Court that Merritt could explain all of the transactions and had receipts showing where all the cash had been used for proper purposes.[44] At the end of this teleconference, Chancellor Chandler decided to enter a modified status quo order:

> You prepare an order that makes it impossible for Miss Merritt to violate any further the status quo order that I have already entered, and that's assuming that she's violated it at all, but in order to make sure that we don't have an issue, and since Miss Merritt's attorney needs time to respond to the motion and to have a hearing, I think that in the meantime, we'll enter a new status quo order that freezes the accounts entirely. That way there won't be any further feud or dispute about the use of the accounts for the entities.[45]

Following the teleconference, Chancellor Chandler entered a Status Quo Order Pending Resolution of Plaintiff's May 8 Motion for Contempt (the "Third Status Quo Order"), which prevented Merritt from commingling or accessing the accounts of the LLCs in any way. [46]

On May 29, 2009, Merritt responded to the Motion for Contempt by arguing that the Plaintiffs had failed to show with clear and convincing evidence that

---

[43] *Id.* at 17:8-13.
[44] *E.g.*, *id.* at 20:3-11 ("Your Honor, I do not have all the details, but I have asked Miss Merritt about this, and the cash withdrawals are made, and the receipts are in the document production. It goes to pay feed, it goes to pay gas for the tractor, it goes to pay whoever, but the receipts are there. It's not money that disappears. Some goes to the employees, and she produced evidence of that. It's not gone in the night.")
[45] *Id.* at 23:13-23.
[46] Status Quo Order Pending Resolution Pl.'s May 8 Mot. Contempt 1, May 20, 2009.

Merritt breached the Status Quo Order.[47] Notably absent from Merritt's Answering Brief are the detailed explanations promised by her counsel during the May 11 teleconference.[48] Merritt provided no explanation for her cash withdrawals.

3. Merritt Moves to Modify the Status Quo Order for a Third Time.

On June 16, 2009, before resolution of the Contempt Motion, Merritt once again moved to modify the Status Quo Order to allow for the payment of her attorneys' fees.[49] Merritt alleged that the Plaintiffs had attempted to make litigation "financially difficult for [Merritt] to defend herself" for several years.[50] Merritt argued that she was entitled to advancement under the LLC Operating Agreements, and that the Plaintiffs were wrongfully withholding advancement because they regretted going into business with Merritt to begin with. On the same day, Merritt's counsel filed an alternative motion to withdraw as counsel.[51] Specifically, Merritt's counsel wrote: "Ms. Merritt has not met her financial

---

[47] Def.'s Opp'n Pls.' Mot. Merritt's Contempt Ct.'s Feb. Order & Status Quo Orders 2, May 29, 2009.
[48] *See* Pl.'s Reply Supp. Mot. Merritt's Contempt, Ex. A, Teleconference 20:3-11, May 11, 2009 (TRANSCRIPT).
[49] Def.'s Renewed Mot. Modify Status Quo Order 1, June 16, 2009.
[50] *Id.* at ¶ 7.
[51] Alternative Mot. Withdraw as Counsel Def. ¶ 5, June 16, 2009 ("Regrettably, . . . in the event the Court's denies Ms. Merritt's Renewed Motion to Modify the Status Quo Order, Phillips Goldman moves to withdraw as counsel to Ms. Merritt effective immediately or, in the event the Court orders a contempt hearing on Plaintiffs' May 8 contempt motion, at the conclusion of the contempt hearing.").

obligations to Phillips Goldman and, without advancement of her attorneys' fees and expenses, will not be able to satisfy those obligations in the near future."[52] The Plaintiffs opposed Merritt's Motion to Modify the Status Quo Order, on the grounds that the Court had already decided it would refrain from deciding substantive issues until the stay was lifted.[53]

4. The Lifting of the Stay

On June 23, 2009, the New York Court of Appeals reversed the lower court's ruling which enjoined the Plaintiffs here from interfering with Merritt's abilities to manage the LLCs.[54] Subsequently, on June 30, 2009, the Plaintiff moved to lift the stay in this action and moved for summary judgment on Count I of its Complaint (the removal claim).[55] R&R argued, in its Motion for Summary Judgment, that the April decision from the Eastern District of Pennsylvania—which found that Merritt had defrauded R&R—was conclusive proof that Merritt had been correctly removed as Manager of the LLCs "for cause." Merritt's counsel declined to respond to the Motion for Summary Judgment until Merritt's Motion to Modify the Status Quo Order was decided.[56]

---

[52] *Id.* at ¶ 8.
[53] Letter to the Honorable William B. Chandler, III from Richard P. Rollo 1-2, June 16, 2009.
[54] Letter to the Honorable William B. Chandler, III from Richard P. Rollo, June 23, 2009, Ex. A.
[55] Pls.' Mot. Vacate Feb. 25 Stay & Summ. J. Count I in C.A. No. 3989, June 30, 2009.
[56] Letter to the Honorable William B. Chandler, III, from Richard P. Rollo, July 7, 2009, Ex. A.

The Court held a teleconference on July 10, 2009 to discuss the pending motions.[57] Finding that the New York Court of Appeals' order was self-executing, Chancellor Chandler determined that the circumstances necessitating a stay in the Delaware actions were no longer present.[58] Therefore, he lifted the stay.[59] During the brief discussion about advancement of Merritt's attorneys' fees, Chancellor Chandler made the following ruling, which is the specific subject of the Supreme Court's reference to me:

> My view is that no one should be advanced any fees in this litigation – neither Ms. Merritt nor any of the plaintiffs who have brought the actions – until the Court is able to resolve finally the rights and liabilities and responsibilities of the various parties involved in this entities. Whether or not parties should remain as managing members, whether they should remain as members and what the respective responsibilities of the various members are in these entities is an open question. And my view is that it would be imprudent to order or authorize advancement of fees before the Court has made those ultimate determinations.
>
> And so based on that reasoning, *I deny the motion to modify the status quo order* to authorize or permit advancement of attorney's fees to Ms. Merritt.[60]

Because Chancellor Chandler denied Merritt's Motion to Modify the Status Quo Order, the Court granted Merritt's counsels' Motion to Withdraw from this

---

[57] Telephonic Rulings Ct. Pets.'/Pls.' Mot. to Vacate Stay, Resp./Def. Merritt's Mot Modify Status Quo Order, Counsel for Resp./Def. Merritt's Mot. to Withdraw, July 10, 2009.
[58] *Id.* at 7:5-16.
[59] *Id.*
[60] *Id.* at 9:4-20 (emphasis added).

action.[61] I have been directed to opine as to whether this decision was "supportable."

During the telephone conference, Chancellor Chandler also decided to postpone ruling on the Motions for Contempt until after he ruled on the merits of the case.[62] At that point, the Court had already received R&R's Motion for Summary Judgment, which explained R&R's argument that the collateral judgment in Pennsylvania necessitated summary judgment as to Merritt's removal. After hearing R&R's basis for summary judgment reiterated during the teleconference, Chancellor Chandler imposed a "fairly aggressive briefing schedule," under which the Motion should have been ready for decision within three weeks.[63] Instead, it took the parties almost two months to completely brief the Motion, and Merritt cross-moved for summary judgment. Ultimately, Chancellor Chandler issued a Letter Decision on September 3, 2009 awarding summary judgment to R&R and appointing a receiver over the LLCs.[64]

On September 10, 2009, Merritt filed a Notice of Appeal to the Supreme Court.[65] The Supreme Court, noting that the Chancery action continued, dismissed the Appeal on October 5, 2009 because Merritt had failed to explain why the Court

---

[61] *Id.* at 14:8-12. From that point forward, Merritt proceeded pro se in Delaware.
[62] *Id.* at 16:15-24.
[63] *Id.* at 18:24.
[64] *R&R Capital, LLC v. Merritt*, 2009 WL 2937101 (Del. Ch. Sept. 3, 2009).
[65] *Merritt v. R&R Capital, LLC*, 3989-CC, Notice of Appeal, Sept. 9, 2009.

of Chancery's interim decision granting partial summary judgment was grounds for interlocutory appeal under Rule 42.[66] After this failed attempt to appeal the Chancery order, Merritt tried several times further to appeal this Court's orders before the case's conclusion.[67] Each time, these requests were denied.[68] Chancellor Chandler ultimately dismissed this case on February 21, 2011.[69] This ruling was a final judgment, from which Merritt appealed on March 23, 2011. On January 14, 2013, this case was remanded to me to discuss a single, limited issue: whether Chancellor Chandler's decision of July 10, 2009 to defer ruling on the issue of attorneys' fees is "supportable."

## III. ANALYSIS

I have been instructed to answer the following question: "Is the trial court's decision to defer ruling on the advancement of attorneys' fees supportable? Whether it is or not, please explain the basis for your decision."[70] I am also instructed not to consider whether Merritt suffered any prejudice as a result of the

---

[66] *Merritt v. R&R Capital, LLC*, 981 A.2d 1173, at *1-2 (Del. Oct. 5, 2009)(ORDER).
[67] *See, e.g.*, Pl.'s [sic] Mot. Certif. Interlocutory Appeal & Mot. Stay Enforcement Pending Appeal, Mar. 8, 2010 (seeking certification to appeal an order of this Court concerning the receivership on March 8, 2010).
[68] *See, e.g., R & R Capital LLC v. Linda Merritt*, 3989-CC, Mar. 11, 2010 (ORDER)(finding Merritt had not met the requirements of Rule 42).
[69] Arg. & Ruling Mot. Dismiss, Mot. Vacate Contempt Order, & Mot. Recusal 106:10-14, Feb. 21, 2011 (TRANSCRIPT).
[70] Supreme Court Order 4, Jan 14, 2013

Chancellor's decision not to award fees.[71] Though Chancellor Chandler deferred ruling on the issue of advancement multiple times, the Supreme Court has expressly asked me to consider whether Chancellor Chandler's decision on July 10, 2009 was supportable.[72] Therefore, I will direct my discussion to the circumstances surrounding that particular decision. I have concluded that the Chancellor's decision is supportable because he appropriately exercised discretion in maintaining the Status Quo Order, thereby preserving the assets that were in dispute.

As an initial matter, Chancellor Chandler had the authority to impose the Status Quo Order. "A court of equity has the power to grant ancillary injunctive relief to protect its jurisdiction over (and the parties entitlement to a meaningful adjudication of their rights in) the property or other matter that is the subject of the action."[73] The decision to enter a status quo order is within the discretion of the trial judge.[74] The party seeking the entry of a status quo order has the burden of

---

[71] *See id.*

[72] *See Merritt v. R&R Capital, LLC*, No. 144, 2011, at 2-3 (Del. Jan. 14, 2013)(ORDER)(quoting Chancellor Chandler's ruling from July 10, 2009).

[73] *E.I. Du Pont de Nemours & Co. v. HEM Research, Inc.*, 576 A.2d 635, 639 (Del. Ch. 1989).

[74] *Cf. Wilmont Homes, Inc. v. Weiler*, 202 A.2d 576, 580 (1964) ("[O]nce a right to relief in Chancery has been determined to exist, the powers of the Court are broad and the means flexible to shape and adjust the precise relief to be granted so as to enforce particular rights and liabilities legitimately connected with the subject matter of the action."). A status quo order is similar to a preliminary injunction in that the purpose of a preliminary injunction is to preserve the status quo. *Gimbel v. Signal Cos.*, 316 A.2d 599, 602 (Del. Ch. 1974) *aff'd*, 316 A.2d 619 (Del. 1974) ("[T]he preliminary injunction constitutes extraordinary relief generally employed 'to do no

showing adequate cause for its imposition.[75] Once the status quo order is in place, the party seeking modification bears the burden of showing why it should be modified.[76] The standard for whether a court has abused its discretion is the following:

> Judicial discretion is the exercise of judgment directed by conscience and reason, and when a court has not exceeded the bounds of reason in view of the circumstances and has not so ignored recognized rules of law or practice so as to produce injustice, its legal discretion has not been abused.[77]

Therefore, if the Chancellor's decision not to modify the status quo order did not exceed "the bounds of reason under the circumstances" and did not ignore

---

more than preserve the status quo pending the decision of the cause at the final hearing on proofs taken.'"). "The appropriateness of entering a status quo order is based on considerations similar to those consulted in determining whether other forms of interlocutory injunctive relief are appropriate." *Pharmalytica Servs., LLC v. Agno Pharms., LLC*, 2008 WL 2721742, at 3 n.6 (Del. Ch. July 9, 2008). Indeed, both the decision to award a preliminary injunction and the decision to impose a status quo order involve factual determinations and the Court's balancing of the equities of the parties. An application for a preliminary injunction 'is addressed to the sound discretion of the court, to be guided according to the circumstances of the particular case.'" *Gimbel*, at 601-02. Given the similarities between these two forms of interim relief, it appears logical to extend the abuse of discretion standard to the Court's decision to impose, or decline to modify, a status quo order. *Cf. Pharmalytica Servs.*, 2008 WL 2721742, at *3 n.6 ("In actions brought under Section 225 of the Delaware General Corporation Law, this Court has entered orders preserving the status quo pending the ultimate resolution of a governance dispute, recognizing that a preliminary injunction would be an awkward form of relief in this setting.").

[75] *See Raptor Sys., Inc. v. Shepard*, 1994 WL 512526, at *2 (Del. Ch. Sept. 12, 1994)("In order to justify entry of a status quo order in a § 225 action, which is essentially a temporary restraining order, *plaintiffs* must demonstrate 1) that the order will avoid imminent irreparable harm; 2) a reasonable likelihood of success on the merits; and 3) that the harm to plaintiffs outweighs the harm to defendants."(emphasis added)).

[76] *See Conn. Gen. Life Ins. Co. v. Pinkas*, 2010 WL 4925832, at *2 (Del. Ch. Nov. 18, 2010) (granting a third-party defendants' motion to modify a status quo order because the moving party demonstrated "good cause" for modification).

[77] *Deibler v. Atl. Properties Group, Inc.*, 652 A.2d 553, 558 (Del. 1995).

"recognized rules of law or practice," then the Chancellor did not abuse his discretion.

The facts of this case support the Chancellor's decision not to modify the Order. The Status Quo Order was entered, originally, to prevent the dissipation of the LLCs' assets during the pendency of the Dissolution Action.[78] R&R supported its request with allegations that assets from the LLCs were unaccounted for and that Merritt had been looting the LLCs by engaging in fraudulent transactions with her boyfriend, Leonard Pelullo, a convicted criminal.

Chancellor Chandler granted the Plaintiff's Motion and entered the Dissolution Status Quo Order on June 12, 2008 "to preserve the respondents' assets in case the Court ultimately ordered dissolution."[79] On September 8, 2008, upon the filing of the Removal Action, the Court considered whether the status quo order, which at the time bound the LLCs, should likewise bind Merritt.[80] Although, at oral argument, Merritt's counsel briefly requested that there should be a "carve out" for attorney's fees from any status quo order,[81] Merritt addressed this theory only tangentially in her brief opposing the entry of a status quo order.[82]

---

[78] *R&R Capital*, 2008 WL 3846318, at *2.
[79] *Id.*
[80] *See* Telephone Conference 7:13-16, Aug. 28, 2008 (TRANSCRIPT).
[81] *Id.* at 18:20-19:4.
[82] *See* Def.'s Response Pl.'s Mot. Status Quo Order 16 n.9, Sept. 3, 2008 ("Plaintiffs cite no reason that this Court should . . . invalidate Merritt's right to advancement of fees and expenses in connection with this litigation as provided for in the operating agreements.").

Thus, the issue of advancement was not ardently propounded by Merritt upon the initial imposition of the Status Quo Order. In entering the Status Quo Order, Chancellor Chandler necessarily determined that R&R had met its burden of showing good cause why a status quo order was necessary. Once the Status Quo Order was entered, however, the burden shifted to Merritt, as the movant, to provide good cause why the Status Quo Order should be modified.[83]

To determine whether Chancellor Chandler's decision was "supportable," I must look to what was known to Chancellor Chandler at the time he made the decision to defer ruling on advancement, on July 10, 2009. Chancellor Chandler had determined, throughout 2008 and 2009, that there were adequate grounds to support three separate Status Quo Orders. [84] In addition to the allegations of malfeasance that supported these decisions, by the time of the July 2009 teleconference, other facts had arisen which reinforced the likelihood of Merritt's dissipating the assets of the LLCs. First, the Eastern District of Pennsylvania had issued a final judgment finding that Merritt had defrauded R&R. This judgment provides substantial evidence that Merritt could not be trusted to safeguard the assets of her litigation adversary, R&R. Furthermore, Merritt knew, as of April 2009, that it was likely that this Court would find her "removed for cause" as

---

[83] *See Conn. Gen. Life Ins. Co. v. Pinkas*, 2010 WL 4925832, at *2 (Del. Ch. Nov. 18, 2010).
[84] These Orders are: the Dissolution Status Quo Order of June 12, 2008; the Status Quo Order of September 8, 2008; and the Third Status Quo Order of May 29, 2009.

Manager of the LLCs. Thus, Merritt had an incentive to transfer as many assets as possible from the LLCs to her personal accounts before such a determination. Chancellor Chandler knew of this judgment, and its potential effects on the litigation, as of June 30, 2009.[85]

Second, on May 8, 2009, R&R moved to hold Merritt in contempt for violating the Status Quo Order, because Merritt had withdrawn large amounts of cash, without documentation, from bank accounts of the LLCs.[86] Tellingly, the Chancellor did not immediately act on R&R's Motion for Contempt. Instead, he deferred ruling on the motion out of caution, as he explained when finally ruling on the (at that point) multiple motions for contempt:

> [T]here are probably a number of missed opportunities where I could have found you [Ms. Merritt] in contempt, but out of a sense of leniency or consideration for your pro se status, I didn't enter earlier orders that I was requested to enter, finding you in contempt for failure to comply with the discovery obligations that you have to comply with, or failing to comply with the Court's status quo order, when you violated it on a number of occasions by writing checks, serially, in excess of the amounts that the status quo order permitted you to write.
>
> So there were a number of instances along the way where I just decided to wait and not do anything. Perhaps that was a mistake on my part and I should have acted on an earlier motion, but I didn't. I waited. I, frankly, waited for this reason, as well, not only out of a sense of leniency or commiseration with your situation, but also because of where the motion was coming from. I don't mean to insult Mr. Rollo or Mr. Sweeney, but I'm going to be very candid with you.

---

[85] Pl.s' Mot. Vacate Stay & Summ. J., June 30, 2009.
[86] Pl.'s Mot. Merritt's Contempt 1, May 8, 2009.

> I don't really trust you, Ms. Merritt, and I don't trust R&R Capital. I think all of you are in business together, and I have grave doubts about the legality of your businesses. I say that reluctantly, but I'm going to be candid with you. I don't think that you operated these LLCs—and that R&R Capital did, either—in a way that was legal and above board. I have so much doubt about that, and I mistrusted you and R&R Capital so much, that I was unwilling to grant contempt orders that they asked me to grant, because of that suspicion about their motives and their good faith in this litigation.[87]

My own examination of the record leads me to a similar conclusion. I find that the record contains substantial evidence that, in the absence of the Status Quo Order, there was a substantial risk that the assets in dispute could have been misappropriated by Merritt. Even when she was subject to the Status Quo Order, Merritt was able to remove over $150,000 of the LLCs' cash, without documentation. Merritt's attempts to rebut R&R's allegations are unpersuasive, and are belied by her conduct when subject to a Court Order, as described in R&R's Motion for Contempt. At the time, Merritt was represented by counsel, who clearly articulated Merritt's position with respect to advancement. Yet Merritt was unable to articulate *any explanation* for her repeated cash withdrawals from the LLCs. Thus the Court appears to have been suspicious, and justifiably so, of Merritt's motives in seeking to modify the Status Quo Order.

---

[87] Arg. & Ruling Mot. Dismiss, Mot. Vacate Contempt Order, & Mot. Recusal 95:4-96:11, Feb. 21, 2011 (TRANSCRIPT).

Even assuming that the LLCs' funds would only be used to pay for Merritt's attorneys' fees, upon a potential modification of the Status Quo Order, there is ample support for the Chancellor's decision to defer ruling on advancement. At the time of Merritt's Motion to Modify the Status Quo Order, the Chancellor was aware of the judgment from the Eastern District of Pennsylvania which found that Merritt had engaged in fraud. Therefore, the Chancellor was aware that, upon a determination of the merits of the suit, it was likely that he would find that R&R validly removed Merritt "for cause." The Chancellor was well aware of the facts and legal claims arising under this case: he had participated in several telephone conferences with the parties, made several rulings, and had already issued one written opinion. Thus, Chancellor Chandler knew that the Pennsylvania ruling was fatal to Merritt's defenses. This knowledge is evident from the expedited briefing schedule Chancellor Chandler suggested to the parties: a mere three weeks to have the merits of the case presented for summary judgment. In other words, the Chancellor, in addressing the Motion to Modify the Status Quo Order, would have had in mind that the issues remaining to litigate were scant, and the incentive on Merritt's part to misuse the lifting of the Status Quo Order correspondingly great.

With the merits of the case essentially finished, few issues remained: (1) who should pay for this litigation, (2) whether Merritt should be found in contempt of Court, and (3) how the business and assets of the LLCs could be efficiently

wound up and distributed. With regard to the first issue, a bare reading of the LLC Agreements suggests that Merritt might have been entitled to advanced fees at the beginning of the Removal Action, if her attorneys had pressed her rights to advancement to the Court.[88] Had Merritt petitioned the Court for specific performance of the LLC Agreements, in order to compel the LLCs to fulfill their advancement obligations to her, she may have been successful. However, that motion was never made.[89] The Status Quo Order protected assets of the LLCs for the principals from various claims and uses. By asking to modify the Status Quo Order, Merritt was effectively asking for the Court to allow preferential use of the funds subject to the Status Quo Order to pay for her own attorneys' fees. That is not the same issue as whether the LLCs should be compelled to fulfill any advancement rights she held.

Following the entrance of the Status Quo Order in September 2008, Merritt moved for a modification of that Order in January 2009. Chancellor Chandler deferred judgment on that issue since it was substantive and Merritt had successfully argued that this case should be stayed. Therefore, this case did not

---

[88] *But see Gary v. Beazer Homes USA, Inc.*, 2008 WL 2510635, at *3-4 (Del. Ch. June 11, 2008) (where termination of rights under an LLC agreement also terminated rights to advancement and indemnification, fees need not be advanced pending a determination of whether the termination was wrongful).

[89] Even if she had asked for specific performance, the record is devoid of any facts showing that Merritt made an undertaking to repay such fees advanced to her, as required by the LLC Agreement. Furthermore, the record is clear that she would not have been able to repay any fees advanced on her behalf.

proceed in the ordinary course for advancement purposes; instead, the deferral of Merritt's advancement claims was a result of her own litigation strategy. Had Merritt not requested a stay in this action, the posture of the case in any hypothetical request for advancement under the LLC Agreements would have been different. Instead, during the pendency of the stay, two damning facts were revealed: that Merritt had defrauded R&R and that Merritt was continuously looting the bank accounts of the LLCs. Therefore, by the time Chancellor Chandler denied the request to modify the Status Quo Order, he knew that Merritt was unlikely to prevail in the Removal Action, which he intended to address promptly.

I find that a sufficient basis existed to support the Chancellor's decision that Merritt had failed to meet her burden to show that the Court should modify the Status Quo order. Chancellor Chandler, therefore, had the discretion to maintain the Status Quo Order. I note that in deciding this issue, as directed, I have not considered whether Merritt was prejudiced by this ruling or whether the result would have been different had she been represented by counsel.

## IV. CONCLUSION

I find that there is support for the Chancellor's July 10, 2009 decision, in his discretion, to maintain the Status Quo Order without modification.[90] To clearly answer the question posed to me by the Supreme Court: The trial court's decision to defer ruling on the advancement of attorneys' fees is supportable.[91]

[90] *See Deibler*, 652 A.2d at 558.
[91] *See* Supreme Court Order 4, Jan 14, 2013.