

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

NATURAL ENERGY)
DEVELOPMENT, INC. and SCOTT)
SHAKESPEARE,)
)
Plaintiffs,)
)
v.) C.A. No. 4836-CS
)
SHAKESPEARE-ONE LIMITED)
PARTNERSHIP, S-1, LLC, WALTER)
CHERNOCH, & LEE SANFT,)
)
Defendants.)

MEMORANDUM OPINION

Date Submitted: June 26, 2013

Date Decided: July 22, 2013

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David L. Finger, Esquire, FINGER & SLANINA, LLC, Wilmington, Delaware, *Attorney for Defendants Shakespeare-One Limited Partnership, S-1, LLC, and Walter Chernoch.*

Lee Sanft, *Pro Se Defendant.*

STRINE, Chancellor.

The plaintiff in this action, Natural Energy Development, Inc. (“Natural Energy”), is the managing general partner of Shakespeare-One L.P. (“Shakespeare-One”), a Delaware limited partnership formed to drill for gas in western Pennsylvania. Natural Energy’s founder, CEO, and coplaintiff is Scott Shakespeare. The defendants relevant to this decision are Shakespeare-One, S-1, which is a Wyoming limited liability company, and Walter Chernoch, who is the managing member of S-1.¹

Under the terms of Shakespeare-One’s Partnership Agreement, Natural Energy, as the managing general partner, is entitled to a 15.94% share of Shakespeare-One’s profits (the “General Partner Interest”). In January 2009, the limited partners of Shakespeare-One purported to remove Natural Energy as the managing general partner of Shakespeare-One and install S-1 in its place.² After Natural Energy’s alleged ouster, Shakespeare-One and S-1 refused to pay Natural Energy the 15.94% General Partner Interest to which it is entitled.

¹ This motion concerns Count I of the Second Amended Complaint, which is directed at Shakespeare-One and S-1 alone. The Second Amended Complaint also names a fourth defendant, Lee Sanft, who is not represented by defense counsel. The defense counsel in this case answered the Original Complaint on behalf of Sanft, along with all other defendants. The counts against Sanft were dismissed. *See* Order (Mar. 10, 2010). When the plaintiffs amended their complaint, they added new counts, and again named Sanft as a defendant. The defense counsel indicated to counsel for the plaintiffs that he was not representing Sanft on these new counts, and the First Amended Complaint was served on Sanft by mail. *See* Letter to the Ct. from Counsel for Pls. (Jan. 9, 2012). Sanft responded to that complaint by letter. There is no evidence in the record, however, that Sanft was served with the Second Amended Complaint, and the electronic filing system still lists defense counsel as representing Sanft. Counsel for the plaintiffs are directed to serve Sanft with the Second Amended Complaint, if they wish to prosecute the action against him. Defense counsel shall also correct the listing on the electronic filing system by taking the appropriate action with the Register in Chancery to update the system to reflect that defense counsel does not represent Sanft any longer, if that is in fact the case.

² Defs.’ Br. in Supp. of Mot. for Summ. J. (Jan. 24, 2013), Ex. 9 (written consent of the limited partners purporting to remove Natural Energy as the managing general partner (Jan. 9, 2009)).

Natural Energy filed suit in August 2009 to assert its rights to its General Partner Interest.³ Natural Energy did not seek to be reinstated as the managing general partner. Nor does it seek to be reinstated now, because it has not been involved in running Shakespeare-One for four years. But, on a previous round of motion practice in March of this year, the defendants conceded, in response to Natural Energy's arguments, that Natural Energy had never been properly removed as the managing general partner of Shakespeare-One.⁴ Thus, the defendants have acknowledged that Natural Energy is owed its General Partner Interest from January 2009 until the present, and, as a matter of law, Natural Energy is currently the managing general partner of Shakespeare-One.

The day after this concession, the limited partners amended the Partnership Agreement to provide that, if Natural Energy does resign or is removed as the managing general partner, Natural Energy will forfeit the General Partner Interest.⁵ Natural Energy then amended its complaint again, and is now seeking summary judgment on Count I, in which it (i) requests a declaratory judgment that it cannot be deprived of the General Partner Interest without its consent whether or not it remains the managing general partner;⁶ (ii) seeks a declaration that it is not the managing general partner of Shakespeare-One;⁷ and (iii) seeks its attorneys' fees for bringing this motion, on the

³ See V. Compl. ¶ 49 (Aug. 26, 2009).

⁴ Defs.' Reply Br. in Supp. of Mot. for Summ. J. 1 (Mar. 5, 2013).

⁵ Pls.' Opening Br. Ex. F (written consent of the limited partners to amend the Partnership Agreement (Mar. 6, 2013)).

⁶ Second V. Am. Compl. ¶ 81.

⁷ *Id.*

ground that the defendants have acted in bad faith.⁸ The defendants oppose summary judgment on the ground that the limited partners have the right to amend the Partnership Agreement so that Natural Energy may be stripped of its General Partner Interest if it resigns or is removed as the managing general partner. And, they deny that they have acted in bad faith.

Because there is a real controversy between the parties, this matter is appropriate for declaratory judgment under 10 *Del. C.* § 6501.⁹ It is also amenable to summary judgment under Court of Chancery Rule 56: there is “no genuine issue as to any material fact,” and the parties have not argued that any of the language in the contract is susceptible of different interpretations.¹⁰ I will address in order the three parts of Natural Energy’s Count I.

First, I conclude that the Partnership Agreement unambiguously vests the General Partner Interest irrevocably in Natural Energy, whether or not Natural Energy ceases to be the managing general partner, and whether or not the limited partners purport to amend the Partnership Agreement to deprive Natural Energy of the General Partner Interest. Section 2.1(l) of the Agreement defines “managing general partner” as “Natural

⁸ *Id.* ¶ 82.

⁹ 10 *Del. C.* § 6501 (“Except where the Constitution of this State provides otherwise, courts of record within their respective jurisdictions shall have power to declare rights, status and other legal relations”); *see Stroud v. Milliken Enters., Inc.*, 552 A.2d 476, 479-80 (Del. 1989) (discussing the requirements for a declaratory judgment action).

¹⁰ Del. Ct. Ch. R. 56(c); *see also Riverbend Cmty., LLC v. Green Stone Eng’g, LLC*, 55 A.3d 330, 334 (Del. 2012) (noting that summary judgment is appropriate in contractual disputes where the language is unambiguous) (citations omitted).

Energy Development Inc., a Florida corporation and its successors and/or assigns.”¹¹

Section 8.1 of the Partnership Agreement defines two types of compensation that the managing general partner is entitled to receive:

The Managing General Partner will receive the following consideration and reimbursement, both directly and indirectly, for serving as the Managing General Partner of the Partnership:

(a) General Partner Interest. Pursuant to Section 4.1, the Managing General Partner has received its 15.94% general partner interest in the Partnership in exchange for services provided to and for the benefit of the Partnership.

(b) Monthly Reimbursement. The Managing General Partner shall receive, on a monthly basis, an administrative fee of \$50 per Prospect Well from the Partnership for its General and Administrative Expenses allocable to the Partnership.¹²

Thus, the Partnership Agreement states that Natural Energy “*has received*” the General Partner Interest for services it has “*provided*” to the Partnership.¹³ This language makes plain that Natural Energy earned the General Partner Interest through the steps it took to set up Shakespeare-One, and therefore that the General Partner Interest has already vested in Natural Energy, whether or not Natural Energy is replaced as the General Partner of Shakespeare-One. By contrast, the \$50 administrative fee per month per well is not vested in Natural Energy, because the managing general partner receives it on an ongoing basis each month to compensate it for the expenses it incurs on behalf of the Partnership.

Other sections of the Partnership Agreement support this conclusion. First, as noted, the very definition of managing general partner indicates that the General Partner

¹¹ Pls.’ Opening Br. Ex. B § 2.1(l) (Shakespeare-One Limited Partnership Agreement) [hereinafter LPA].

¹² *Id.* § 8.1.

¹³ *Id.*

Interest belongs to Natural Energy and “its successors and/or assigns.”¹⁴ As counsel for defendants conceded at an earlier stage of these proceedings,¹⁵ the phrase “successor and/or assigns” implies an entity that succeeds to Natural Energy’s rights in a process such as a merger, or to which Natural Energy assigns its General Partner Interest—not simply an entity that the limited partners install to replace Natural Energy.¹⁶

Next, Section 4.1, which is referenced by Section 8.1, provides:

The Managing General Partner shall acquire its 15.94% general partner interest in the Partnership *in consideration of services rendered to or for the benefit of the Partnership*. . . . *The Managing General Partner shall not have any further obligations to contribute money or otherwise to, or in respect of, the liabilities or obligations of the Partnership.*¹⁷

Section 4.1 thus shows that the managing general partner earned its General Partner Interest from Shakespeare-One by the act of creating the Partnership, and does not have to continue to perform any services to the Partnership to retain the interest. The logical implication of this is that the General Partner Interest has become Natural Energy’s property, and cannot be taken away by the limited partners, even if they remove Natural Energy as managing general partner or amend the Partnership Agreement. As Vice Chancellor Lamb observed in *Walker v. Resource Development Co.*, it is a

¹⁴ *Id.* § 2.1.

¹⁵ Tr. of Oral Arg. on Defs.’ Mot. to Dismiss 4:20-5:5 (Feb. 23, 2010).

¹⁶ *See, e.g., Black’s Law Dictionary* (9th ed. 2009) (defining “assign[ee]” as “[o]ne to whom property rights or powers are transferred by another,” and “successor” as “[a] corporation that, through amalgamation, consolidation, or other assumption of interests, is vested with the rights and duties of an earlier corporation”); *see also Larkin v. City of Burlington*, 772 A.2d 553 (Vt. 2001) (holding that “[t]he boilerplate language ‘successors and assigns,’ when referring to corporations, ordinarily applies only when another corporation, through legal succession, assumes the rights and obligations of the first corporation,” and did not denote a party that purchased an asset from the corporation (citation omitted)).

¹⁷ LPA § 4.1 (emphasis added).

“fundamental principle under Delaware law that a majority of the members . . . of a business entity, unless expressly granted such power by contract, have no right to take the property of other members.”¹⁸

Any remaining doubt that Natural Energy’s General Partner Interest is vested in Natural Energy, and does not attach to whichever individual or entity is serving as the managing general partner at that particular time, is dispelled by Section 9.3.1(c), which sets out the conditions on which Natural Energy may be replaced:

At a meeting called for the purpose, a ninety percent (90%) of the Additional General and Limited Partners collectively may remove the Managing General Partner and, upon such removal, elect a substitute Managing General Partner. . . . The substitution of the new Managing General Partner shall be effective only if and when the following conditions have been satisfied:

...
(c) *all the rights and interests of the Managing General Partner with respect to any interest it may hold as a partner shall continue.*¹⁹

Thus, Natural Energy does not lose its General Partner Interest simply by being replaced as the managing general partner. The defendants do not challenge the force of any of these provisions. Instead, the defendants rely entirely on Section 12.1 of the Partnership Agreement, which sets out the method whereby the limited partners may amend the Agreement. Section 12.1 provides, in part, that

[a]n amendment or amendments to this Agreement also may be proposed by Additional General and Limited Partners whose aggregate partnership interests equal or exceed fifty percent (50%) of all Additional General and Limited Partners’ interests . . . provided, however, that (i) no amendment

¹⁸ *Walker v. Res. Dev. Co.*, 791 A.2d 799, 815 (Del. Ch. 2000); *see also Salaman v. Nat’l Media Corp.*, 1992 WL 808095, at *6 (Del. Super. Ct. Oct. 8, 1992) (noting that one party may not “unilaterally rescind a vested contract right upon which [the other party] relied”).

¹⁹ LPA § 9.3.1.

shall reduce an *Additional General and Limited Partner's* interest in the Partnership unless the writing is executed by him, (ii) no amendment shall effect any change in this Section unless the writing is executed by all the *Additional General and Limited Partners*, and (iii) no amendment shall effect any change in any provision of this Agreement providing for action to be taken by a specified percentage of interests in the Partnership unless the writing is executed by *Additional General and Limited Partners* whose aggregate Partnership interests at least equal the percentage specified in the provision to be changed.²⁰

The defendants claim that this language restricts the ability of the limited partners to alter the interests of the limited partners and “Additional General Partners”—partners who are general partners, but not the managing general partner—yet does nothing to restrict the ability of the limited partners to alter the interests of the managing general partner. But, Delaware courts interpret and construe contracts “as a whole,” and the defendants’ proposed construction is inconsistent with the rest of the Partnership Agreement, which shows that the General Partner Interest was vested irrevocably in Natural Energy by Section 8.1, and that the Partnership Agreement cannot be amended to strip Natural Energy of the General Partner Interest.²¹

Nothing in the text of Section 12.1 gives any hint that it provides a basis for an amendment to the Limited Partnership Agreement to interfere with the managing general partner’s ownership of its vested General Partner Interest at all, although the managing general partner is still free to dispose of its General Partner Interest, if it wishes.²²

²⁰ *Id.* § 12.1 (emphasis added).

²¹ *See, e.g., Osborn ex rel. Osborn v. Kemp*, 991 A.2d 1153, 1159 (Del. 2010) (quoting *Kuhn Constr., Inc. v. Diamond State Port Corp.*, 990 A.2d 393, 396-97 (Del. 2010)).

²² *See* LPA § 10.3 (“Notwithstanding any other provision of this Article X, the Managing General Partner may mortgage, pledge, hypothecate or grant a security interest in any part of its

Because it is clear from the rest of the Partnership Agreement that the General Partner Interest was vested irrevocably in the managing general partner, there was no need for Section 12.1 to contain a separate condition restricting the ability of the limited partners to affect the managing general partner's interest in the Partnership. There was, by contrast, a need to protect the classes identified in Section 12.1, the limited partners and additional general partners, because no other clear contractual language gave them a plain protection against further dilution. However much the Florida-based defendants may like a Cuban sandwich, they may not act by self-interested fiat to expropriate the vested ownership interest in Shakespeare-One clearly given to the managing general partner by Section 8.1.

Furthermore, the defendants' proposed reading of Section 12.1 makes no apparent logical sense, and the defendants do not attempt to fill that void with a rational explanation. The defendants have not offered any reason why the parties would have carefully contracted in Section 12.1 to protect the rights of limited partners and additional general partners, who must agree in writing to any change to the Partnership Agreement that affects their rights, but apparently leave the managing general partner completely unprotected and subject to an uncompensated taking. Instead, the defendants simply argue that Delaware is a contractarian state and that I must enforce Section 12.1 as written. But I cannot apply Section 12.1 in a strange way that is inconsistent with the rest of the Partnership Agreement, when there is a clearly superior alternative that makes

interest in the Partnership as collateral for a loan or loans, provided, however, that the mortgagee or pledgee shall hold such interest subject to all of the terms of this Agreement.”).

sense of the entire contract.²³ For these reasons, the limited partners' amendment to the Partnership Agreement is invalid insofar as it purports to provide that Natural Energy will be divested of its General Partner Interest on withdrawing from Shakespeare-One, or otherwise interferes with Natural Energy's General Partner Interest.

I now move to Natural Energy's request for a declaration that it is not the managing general partner of Shakespeare-One. The defendants do not oppose this request. Rather, after the defendants conceded in March this year that Natural Energy had not been properly removed as the managing general partner of Shakespeare-One, their hope seems to have been that they could remove Natural Energy again, and properly install S-1, after changing the Partnership Agreement to provide that Natural Energy would not be entitled to any General Partner Interest after being removed. S-1 has been the *de facto* managing general partner of Shakespeare-One for over four years, and forcing Natural Energy to resume the role against its will after its involuntary removal and a lengthy period of forced absence would be inequitable and, at this point, threaten Shakespeare-One's wealth-creating potential. Thus, I grant Natural Energy's request for a declaration that it is not the managing general partner of Shakespeare-One, and that S-1 is the managing general partner.

Finally, Natural Energy claims that it is entitled to attorneys' fees under the bad-faith exception to the American Rule.²⁴ Natural Energy claims that the defendants have acted in bad faith by arguing between the start of this litigation, in August 2009, and May

²³ See *Osborn*, 991 A.2d at 1159; *Kuhn*, 990 A.2d at 396-97.

²⁴ See *Johnston v. Arbitrium (Cayman Is.) Handels AG*, 720 A.2d 542, 545-46 (Del. 1998).

2013 that Natural Energy was properly removed as the managing general partner, but then finally conceding that Natural Energy's removal was improper. This, Natural Energy says, unnecessarily prolonged the litigation, and thus warrants fee-shifting.²⁵

The bad-faith exception to the American Rule is applied in “extraordinary circumstances,” and there is no reason to apply the exception here.²⁶ As an initial matter, the conduct of which Natural Energy complains—the defendants' insistence, for the better part of four years, that Natural Energy was properly removed as the managing general partner—is not relevant to this motion. This motion for declaratory judgment is whether Natural Energy has a vested right to the General Partner Interest, regardless of whether it was properly removed as managing general partner. If Natural Energy was to use the defendants' belated concession to support a claim of fee-shifting, it should have sought fees for its previous motion, where the concession was directly on point and mooted two counts of the complaint.²⁷

Second, even if the defendants' concession was relevant to this motion, it would not justify fee-shifting. The defendants did not stick stubbornly, for four years, to the claim that Natural Energy was properly removed, despite Natural Energy's arguments to the contrary. Rather, Natural Energy only raised the argument that it was not properly removed in the course of briefing the cross-motions for summary judgment three months

²⁵ *See id.* at 546 (noting that unnecessarily prolonging litigation may justify fee-shifting).

²⁶ *Montgomery Cellular Hldg. Co. v. Dobler*, 880 A.2d 206, 227 (Del. 2005) (citation omitted).

²⁷ *See* Stip. Order (May 3, 2013).

ago.²⁸ The defendants immediately conceded this point, and Natural Energy has not shown that the defendants were aware that Natural Energy had not been properly removed before this time.²⁹ Therefore, Natural Energy has not shown that the defendants were acting in bad faith and that fee-shifting under the American Rule is warranted.

In conclusion, I grant summary judgment to Natural Energy and Shakespeare on Count I of the Second Amended Complaint, except insofar as they seek their attorneys' fees. Natural Energy is to submit an implementing order within five days, after notice as to form to the defendants.

²⁸ See Pls.' Ans. Br. 13-14 (Feb. 22, 2013); *see also* Tr. of Oral Arg. on Cross Mot. for Summ. J. 16:13-17 (Apr. 22, 2013).

²⁹ Defs.' Reply Br. in Supp. of Mot. for Summ. J. 1 (Mar. 5, 2013).