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COURT OF CHANCERY
OF THE
STATE OF DELAWARE

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Re: *Florida R&D Fund Investors, LLC v. Florida BOCA/Deerfield R&D Investors, LLC, et al.*
C.A. No. 8400-VCN
Date Submitted: May 10, 2013

Dear Counsel:

Plaintiff Florida R&D Fund Investors, LLC ("R&D"), a member of Defendant Florida BOCA/Deerfield R&D Investors, LLC (the "Joint Venture"), brought a books and records action under 6 *Del. C.* § 18-305 and the Joint Venture's limited liability company agreement. R&D seeks two categories of books and records that are in the possession and control of Defendant HDG Mansur Investment Services, Inc. ("Investment Services"), which, until recently, managed the Joint Venture's assets. R&D offers two reasons to support its

inspection requests: appointing a new asset manager and investigating and determining the extent of possible mismanagement at the Joint Venture.

The primary question focuses on whether this Court has jurisdiction over Investment Services, an Indiana corporation, under either Delaware's long-arm statute or its Limited Liability Company Act (the "LLC Act").[1] Whether the LLC Act confers jurisdiction will depend upon whether Investment Services is a manager of the Joint Venture or whether its asset management activities constitute material participation in the management of the Joint Venture.

Defendants, other than the Joint Venture, have moved to dismiss under Court of Chancery Rules 12(b)(2) and 12(b)(6).

I. BACKGROUND[2]

A. *Parties*

R&D holds an approximately 87% interest as a member in the Joint Venture. The Joint Venture, a Delaware limited liability company, "was formed to invest in,

[1] 6 *Del. C.* ch. 18.
[2] The facts below are taken from the Plaintiff's Verified Complaint for Inspection of Books and Records Pursuant to 6 *Del. C.* § 18-305 (the "Complaint" or "Compl."). For the purposes of considering the Defendants' motion to dismiss, they are presumed to be true. *Malpiede v. Townson*, 780 A.2d 1075, 1082 (Del. 2001). The Limited Liability Company Agreement of Florida BOCA/Deerfield R&D Investors, LLC (the "LLC Agreement") is Exhibit A to the Complaint.

own, develop, and operate a real estate project" in Florida (the "Project").[3] The other Defendants (the "HDG Defendants") are companies affiliated with, and under the control of, Harold D. Garrison ("Garrison").[4] The HDG Defendants' primary location is Indianapolis, Indiana.[5]

Defendant HDG Florida Research, LLC ("HDG Florida") and Defendant HDG Florida Research II, LLC ("HDG Florida II") are Delaware limited liability companies and members of the Joint Venture (collectively, the "HDG Members"). The HDG Members hold an approximately 13% interest in the Joint Venture. Defendant HDG Mansur Properties, Inc. ("HDG Properties") is an Indiana corporation. Defendant HDG Mansur Capital Group, LLC ("HDG Capital") is a Delaware limited liability company. HDG Capital guaranteed certain obligations of the HDG Members and HDG Properties. Investment Services, until its recent termination, served as asset manager for the Joint Venture and its subsidiary companies (collectively, the "Group Companies").[6]

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[3] Compl. ¶ 5.
[4] *Id.* ¶ 12.
[5] *Id.* ¶¶ 6-12.
[6] *Id.* ¶ 11.

B. *The Relevant Agreements*

1. The LLC Agreement

The Joint Venture was created in March 2008 and is governed by the LLC Agreement,[7] which allows for the books and records of the Joint Venture to be maintained by a third party selected by the Board of Directors.[8] Section 5.3 of the LLC Agreement provides that:

> - The Board of Directors shall cause to be kept full and accurate records of the Group Companies' affairs.
>
> - The Group Companies' books and records, this Agreement and the Certificate of Formation and all amendments thereto, the Master Lease Financing Documentation, and all other records required to be maintained by [the Joint Venture] and the other Group Companies pursuant to the LLC Act shall be maintained or caused to be maintained by the Board of Directors and shall be made available to the Members at a reasonable location.
>
> - The Members, their internal staff and their counsel and accountants shall have the right at any time during normal business hours to inspect and audit all such books and records, to make copies thereof and to take extracts therefrom.

[7] The LLC Agreement has since been amended in ways not material to this action.
[8] *Id.* ¶ 14; LLC Agreement § 5.3 ("The Group Companies' books and records . . . shall be maintained or caused to be maintained by the Board of Directors . . . .").

> - The Board of Directors shall ensure that all deeds, Leases, contracts, title matters, surveys and other documentation, records and financial information relating to the ownership, maintenance, development and sale of Properties are maintained in safekeeping and organized and accessible to the Members.
>
> - The Board of Directors shall promptly deliver to the Members, upon request, and at the expense of [the Joint Venture], a copy of the information required to be maintained by the LLC Act and this Agreement.

2. The Asset Management Agreement

The LLC Agreement anticipated that Investment Services would provide asset management services for the Group Companies.[9] In March 2008, the Joint Venture and Investment Services executed the Asset Management Agreement,[10] which was then incorporated into the LLC Agreement.[11]

Investment Services was required under the Asset Management Agreement to "advise [the Joint Venture] and the other Group Companies on how best to

[9] Compl. ¶ 15; LLC Agreement, Recital (E).
[10] Compl. ¶ 15. The Asset Management Agreement between the Joint Venture and Investment Services is Exhibit B to the Complaint. Garrison also signed the Asset Management Agreement on behalf of Investment Services.
[11] *Id.* ¶ 16. The Court may consider the LLC Agreement and the Asset Management Agreement for the purposes of deciding the Defendants' motion to dismiss because they are "integral to . . . [the] claim and incorporated into the complaint" as exhibits. *Vanderbilt Income & Growth Assocs., L.L.C. v. Arvida/JMB Managers, Inc.*, 691 A.2d 609, 613 (Del. 1996). The Asset Management Agreement is governed by New York law. Asset Management Agreement § 17.

preserve and enhance the asset value of the Properties and to provide asset management services to the Joint Venture and the other Group Companies."[12] The Asset Management Agreement states that Investment Services "is an independent contractor and is not acting as agent, partner, joint venturer, lessee, coprincipal, or associate of any Group Company or any person claiming by, through or under any Group Company, in the conduct of any Group Company's businesses."[13]

Although R&D characterizes Section 3 of the Asset Management Agreement as imposing an "obligation" on Investment Services to maintain the books and records of the Joint Venture,[14] the Defendants instead contend that there is no such

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[12] Compl. ¶ 17 (citing Asset Management Agreement, Recital (E)). "Properties" here refers to the Project.

[13] Asset Management Agreement § 6(B).

[14] Compl. ¶ 18. In its Answering Brief, R&D revises its argument to suggest instead that Investment Services' "obligation" to maintain the books and records of the Joint Venture arises under Section (2)P of the Asset Management Agreement. Pl.'s Answering Br. in Opp'n to Defs.' Mot. to Dismiss under Ct. Ch. Rules 12(b)(2) and 12(b)(6) ("AB") 21. Section 2(P) of the Asset Management Agreement states that Investment Services "shall provide all other services incidental to the foregoing and necessary or appropriate for the management of the Group Companies." Asset Management Agreement § 2(P). According to R&D, Investment Services would have been unable to discharge its duties under Section 2(P) of the Asset Management Agreement unless it also maintained the books and records of the Joint Venture. AB 21.

Leaving aside the question of whether this is merely a "scrivener's error" as suggested by R&D, *id.* 21 n.18, or is in fact a novel argument R&D raised for the first time in its Answering Brief, neither Section (2)P nor Section 3 of the Asset Management explicitly imposes an obligation on Investment Services to maintain the Joint Venture's books and records.

R&D's argument, regardless of whichever section of the Asset Management Agreement on which it is based, attempts to find a contractually agreed obligation for Investment Services to

obligation, because Section 3: "(1) only addresses certain financial reporting requirements which are not at issue in this case; (2) does not mention maintenance of the Joint Venture's books and records; [and] (3) does not cite to or reference the LLC Agreement's Section 5.3 books and records clause."[15]

The parties do not dispute that, to the extent of R&D's knowledge, the two categories of books and records sought by R&D are currently in the possession of Investment Services,[16] and physically located in either Indianapolis, Indiana or Boca Raton, Florida.[17]

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maintain the Joint Venture's books and records implied within its other responsibilities as stated in the Asset Management Agreement. As the Court understands it, R&D does not argue that there are provisions of the Asset Management Agreement which explicitly and specifically obligate Investment Services to maintain the books and records of the Joint Venture.

[15] Defs.' Opening Br. in Supp. of their Mot. to Dismiss under Ct. Ch. Rules 12(b)(2) and 12(b)(6) ("OB") 16.

[16] Compl. ¶ 18; OB 2. When asked by the Court whether books and records were sought from any of the HDG Defendants other than Investment Services, R&D responded that its expectation was that the books and records at issue were solely with Investment Services. *Fla. R&D Fund Investors, LLC v. Fla. BOCA/Deerfield R&D Investors, LLC*, C.A. No. 8400-VCN, at 30 (Del. Ch. May 10, 2013) (TRANSCRIPT) ("Tr."). According to R&D, the only information it is "aware of and can affirmatively allege and have alleged in the complaint" relates to Investment Services. *Id.* 31. However, one of the categories of books and records sought by R&D consists of internal e-mails, and according to R&D, "there is a single domain name that the entities use for e-mail correspondence, and it's difficult in that context to tell exactly which entity may actually have the records." *Id.* 30-31.

[17] Compl. ¶ 18.

3. The Suspension Agreement

In 2009, HDG Florida II became unable to fund its proportionate share of additional capital required by the LLC Agreement. As a result, on October 9, 2009, the Joint Venture and Investment Services entered into a suspension agreement (the "Suspension Agreement"), under which, if R&D made an excess payment to fund a deficient capital contribution by the HDG Members, then the payment of the management fee under the Asset Management Agreement to Investment Services would be suspended.[18]

The Suspension Agreement further allowed R&D to terminate the Asset Management Agreement on behalf of the Joint Venture upon the failure of HDG Florida II to make certain capital contributions when due.[19] After HDG Florida II failed to make several such contributions when due, R&D, on January 17, 2013, terminated the Asset Management Agreement.[20]

[18] *Id.* ¶ 19, Ex. C. (Suspension Agreement) § 2.1.
[19] *Id.*; Suspension Agreement § 3.1.
[20] Compl. ¶ 20.

C. *Plaintiff's Demand for Books and Records*

R&D decided to exercise its right to inspect the Joint Venture's books and records in February 2013 after it learned of: (i) an e-mail chain suggesting an unauthorized payment to Investment Services by the Joint Venture, and (ii) an action filed in the United States District Court for the Southern District of New York against Investment Services by some of its other fund clients concerning allegedly improper payments.[21]

First, R&D alleges that it discovered emails among officers and employees of the HDG Defendants[22] suggesting that Investment Services was being paid fees to which it was not entitled and that the HDG Defendants were attempting to conceal the payments from the Joint Venture's auditors.[23]

In a December 1, 2011 email chain, Etter wrote to Garrison: "ok on the 200K total from FAU [a project]. we will be holding paying some things so will need back," to which Garrison responded: "tell Brian [Reeve]."[24] Reeve then informed Garrison: "[w]ith suspension in place, this will get caught with

[21] *Id.* ¶ 28.
[22] These officers and employees included Garrison, Douglas L. Etter ("Etter"), Brian Reeve ("Reeve"), and Nathan Gabbert ("Gabbert"). *Id.* ¶¶ 24-26.
[23] *Id.* ¶ 23.
[24] *Id.* ¶ 24, Ex. D.

subsequent events in audit."[25] Reeve also wrote to Gabbert: "[n]ow we need to make sure we get it paid back prior to [the Joint Venture's auditor] asking for subsequent event cash activity."[26] Gabbert's February 1, 2012, email on the subject of "FAU [the Project] $200k" to Reeve asked: "Did Harold [D. Garrison] have any feedback on your suggestion to hide part of this in accum[ulated] depr[eciation]?"[27] Reeve responded, "Go forward with that."[28]

Second, R&D learned that an action had been filed in the United States District Court for the Southern District of New York against Investment Services, alleging that it had made improper payments to itself in connection with an unrelated fund management agreement.[29]

On February 19, 2013, R&D delivered a demand for the Joint Venture's books and records to the Joint Venture, the HDG Members, HDG Properties, and Investment Services.[30] The HDG Defendants allowed copies to be made of some

[25] *Id.*
[26] *Id.* ¶ 25, Ex. D.
[27] *Id.* ¶ 26, Ex. E.
[28] *Id.*
[29] *Id.* ¶ 27.
[30] *Id.* ¶ 29.

of the Joint Venture's books and records, but they did not grant access to all of the books and records requested by R&D.[31]

On February 27, 2013, R&D sent a supplemental demand seeking the remaining books and records to which it had not been granted access (the "February 27 Demand")[32] and, in particular, sought the following:

> 1. All email or other internal or external correspondence regarding any payments made to HDG Mansur Investment Services, LLC, or any of its affiliates, or any officers, directors, employees or agents of the foregoing;
>
> 2. Related party listing, transaction detail and support for October 1, 2008 – January 31, 2013.[33]

On February 28, 2013, Investment Services responded by stating that it would not provide R&D with emails or correspondence regarding payments made to itself or to its affiliates, officers, directors, employees, or agents. Investment Services also refused to make available to R&D a related party listing or to provide an account receivable ledger beyond its tenant ledgers.[34]

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[31] *Id.* ¶ 30.
[32] *Id.* ¶ 31.
[33] *Id.* ¶ 31, Ex. F.
[34] *Id.* ¶ 32.

II. CONTENTIONS

R&D seeks two categories of books and records now in the possession of Investment Services under 6 *Del. C.* § 18-305 and Section 5.3 of the LLC Agreement.[35] The HDG Defendants, in moving to dismiss under Court of Chancery Rules 12(b)(2) and 12(b)(6), assert that: (i) this Court does not have personal jurisdiction over Investment Services or HDG Properties; (ii) there is no statutory or contractual obligation binding Investment Services or any of the other HDG Defendants under 6 *Del. C.* § 18-305 or Section 5.3 of the LLC Agreement that entitles R&D to inspect the books and records it seeks; and (iii) R&D has not articulated a proper purpose to justify the production of the two categories of books and records at issue. At the core of this dispute is the right of a member of a limited liability company to inspect books and records not held by the limited liability company.

[35] *Id.* ¶¶ 1-3, 14, 31, 33.

III. ANALYSIS

A. *Standard of Review*

1. Court of Chancery Rule 12(b)(2)

When confronted with a motion to dismiss challenging the Court's personal jurisdiction, the plaintiff bears the burden of showing a basis for the Court's exercise of jurisdiction over a defendant.[36] The Court conducts "a two-step analysis to determine whether the exercise of personal jurisdiction over a nonresident is appropriate."[37] First, the Court considers "whether 'Delaware statutory law offers a means of exercising personal jurisdiction' over the nonresident defendant."[38] Second, "after establishing a statutory basis for jurisdiction, the [C]ourt must determine 'whether subjecting the nonresident to jurisdiction in Delaware violates the Due Process Clause of the Fourteenth Amendment.'"[39] The due process analysis involves the Court deciding "as a

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[36] *Werner v. Miller Tech. Mgmt., L.P.*, 831 A.2d 318, 326 (Del. Ch. 2003).
[37] *Amaysing Techs. Corp. v. CyberAir Commc'ns., Inc.*, 2005 WL 578972, at *3 (Del. Ch. Mar. 3, 2005) (citing *Hercules Inc. v. Leu Trust & Banking (Baha.) Ltd.*, 611 A.2d 476, 480 (Del. 1992)).
[38] *Id.* (quoting *Hart Hldg. Co. v. Drexel Burnham Lambert Inc.*, 1992 WL 127567, at *2 (Del. Ch. May 28, 1992)).
[39] *Ruggiero v. FuturaGene, plc.*, 948 A.2d 1124, 1132 (Del. Ch. 2008) (quoting *Amaysing Techs.*, 2005 WL 578972, at *3).

matter of fact, whether the defendant had enough connection with the state so that it does not offend traditional notions of fair play and justice for the Court to exercise jurisdiction."[40]

In deciding a Rule 12(b)(2) motion to dismiss, the Court "may consider the pleadings, affidavits, and any discovery of record."[41] If no evidentiary hearing has been held, plaintiffs only need to make a *prima facie* showing of personal jurisdiction,[42] and "the record is construed in the light most favorable to the plaintiff."[43]

2. Court of Chancery Rule 12(b)(6)

On a motion to dismiss for failure to state a claim, the Court:

> should accept all well-pleaded factual allegations in the Complaint as true, accept even vague allegations in the Complaint as "well-pleaded" if they provide the defendant notice of the claim, draw all reasonable inferences in favor of the plaintiff, and deny the motion unless the plaintiff could not recover under any reasonably conceivable set of circumstances susceptible of proof.[44]

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[40] *Benerofe v. Cha*, 1996 WL 535405, at *3 (Del. Ch. Sept. 12, 1996) (citing *Hart Hldg. Co. Inc. v. Drexel Burnham Lambert Inc.*, 593 A.2d 535, 538 (Del. Ch. 1991)).
[41] *Cornerstone Techs., LLC v. Conrad*, 2003 WL 1787959, at *3 (Del. Ch. Mar. 31, 2003).
[42] *See Benerofe*, 1996 WL 535405, at *3.
[43] *Cornerstone Techs.*, 2003 WL 1787959, at *3 (citation omitted).
[44] *Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Hldgs. LLC*, 27 A.3d 531, 537 (Del. 2011).

In deciding a Rule 12(b)(6) motion to dismiss, the Court may review documents outside the pleadings if "the document is integral to [the] plaintiff's claim and incorporated in the complaint."[45] The Court "need not 'accept conclusory allegations unsupported by specific facts or . . . draw unreasonable inferences in favor of the non-moving party,'"[46] but the Court will deny a Rule 12(b)(6) motion to dismiss "as long as there is a reasonable possibility that a plaintiff could recover."[47]

B. *Jurisdiction over Investment Services*

Investment Services is an Indiana corporation with an Indiana address.[48] The two categories of books and records sought by R&D were created, maintained, and held by Investment Services in either Indiana or Florida.[49] R&D does not allege that the books and records were ever maintained or located in Delaware.[50] Although Investment Services entered into the Asset Management Agreement with

[45] *Allen v. Encore Energy P'rs, L.P.*, 2013 WL 3803977, at *1 n.2 (Del. July 22, 2013).
[46] *In re Alloy, Inc. S'holder Litig.*, 2011 WL 4863716, at *6 (Del. Ch. Oct. 13, 2011) (quoting *Price v. E.I. DuPont de Nemours & Co.*, 26 A.3d 162, 166 (Del. 2011)).
[47] *Gerber v. EPE Hldgs., LLC*, 2013 WL 209658, at *4 (Del. Ch. Jan. 18, 2013), *aff'd in part, rev'd on other grounds*, 67 A.3d 400 (Del. 2013).
[48] Compl. ¶ 11.
[49] *Id.* ¶ 18; OB 9 n.7.
[50] *See, e.g.*, Compl. ¶¶ 5, 11, 18.

the Joint Venture, "[a] non-resident's entering into a contract with a domicile of the forum State has been held insufficient, in and of itself, to permit the exercise of personal jurisdiction over the [non-resident]."[51] The Asset Management Agreement provides for the management of assets based in Florida, and the agreement is to be governed by New York law. R&D bears the burden of establishing a basis for the Court's exercise of jurisdiction over Investment Services. R&D argues that the Court may exercise jurisdiction over Investment Services under Delaware's long-arm statute, 10 *Del. C.* § 3104, and the service of process provisions of the LLC Act, 6 *Del. C.* § 18-109(a)(i) and (ii). It further contends that the exercise of jurisdiction is consistent with due process.

1. The Long-Arm Statute

R&D invokes Delaware's long-arm statute to obtain jurisdiction over Investment Services.[52] R&D argues that Investment Services is "subject to the personal jurisdiction of this Court under 10 *Del. C.* § 3104(c)(1)" because of its "active[] participat[ion] in the management of the Joint Venture."[53] Under that

[51] *In re Rehab. of Nat'l Heritage Life Ins. Co.*, 656 A.2d 252, 256 (Del. Ch. 1994).
[52] 10 *Del. C.* § 3104.
[53] AB 14.

subsection of Delaware's long-arm statute, the Court may exercise jurisdiction over a nonresident if "the nonresident transacted some sort of business in the state, and . . . the claim being asserted arose out of that specific transaction."[54] Merely participating in the management of a Delaware entity—with no allegation of "extensive and continuing contacts with Delaware"—does not subject a party to this Court's long-arm jurisdiction.[55] There simply is no allegation in the Complaint that Investment Services took any actions, let alone actions giving rise to R&D's claims, inside the State of Delaware. The books and records that it maintained and the assets that it managed are located either in Florida or Indiana. The Complaint alleges nothing about what Investment Services did in Delaware with respect to the Joint Venture, and there is no allegation that Investment Services was involved in the formation of the Joint Venture or of any of the other related Delaware entities. Accordingly, the Court declines to exercise jurisdiction over Investment Services under the long-arm statute.[56]

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[54] *Fisk Ventures, LLC v. Segal*, 2008 WL 1961156, at *7 (Del. Ch. May 7, 2008).
[55] *Metro. Life Ins. Co. v. Tremont Gp. Hldgs. Inc.*, 2012 WL 6632681, at *5 (Del. Ch. Dec. 20, 2012).
[56] If R&D were correct that participation in the management of a Delaware limited liability company subjects a party to jurisdiction under the long-arm statute, there would be no need for the specific provisions in the LLC Act that allow the Court to exercise jurisdiction over a party

2. Section 18-109 of the LLC Act

Section 18-109 of the LLC Act authorizes service of process on persons serving as managers of Delaware limited liability companies

> in all civil actions or proceedings brought in the State of Delaware involving or relating to the business of the limited liability company, or a violation by the manager . . . of a duty to the limited liability company or any member of the limited liability company, whether or not the manager . . . is a manager . . . at the time suit is commenced.[57]

Service as a manager "constitutes such person's consent to the appointment of the registered agent of the limited liability company (or, if there is none, the Secretary of State) as such person's agent upon whom service of process may be made as provided in this section."[58] Managers of Delaware limited liability companies are thus deemed to have consented to the jurisdiction of the Court in litigation arising out of their service as managers.[59]

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that is a manager of, or materially participates in the management of, that limited liability company.

[57] 6 *Del. C.* § 18-109(a).

[58] *Id.*

[59] *See, e.g.*, *Assist Stock Mgmt. L.L.C. v. Rosheim*, 753 A.2d 974, 982 (Del. Ch. 2000).

> For purposes of service of process, "manager" refers:
>
> (i) to a person who is a manager as defined in § 18-101(10) of [the LLC Act] and
>
> (ii) to a person, whether or not a member of a limited liability company, who, although not a manager as defined in § 18-101(10) of [the LLC Act], participates materially in the management of the limited liability company.[60]

R&D argues that the Court may exercise jurisdiction over Investment Services under either subsection.[61]

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[60] 6 *Del. C.* § 18-109(a). *See also Vichi v. Koninklijke Philips Elecs. N.V.*, 2009 WL 4345724, at *4 (Del. Ch. Dec. 1, 2009).

[61] The HDG Defendants first contended that R&D failed to effectuate service on Investment Services under the two-step process required by Section 18-109(b) in their Reply Brief. Defs.' Reply Br. in Supp. of their Mot. to Dismiss under Ct. Ch. Rules 12(b)(2) and 12(b)(6) 4. The HDG Defendants also asserted that R&D failed to cite Section 18-109(a) in either (i) the Supplemental Information Sheet filed with the Court that asked R&D to provide the "[b]asis of [the] court's jurisdiction (including the citation of any statute conferring jurisdiction)," or (ii) the Summons requested from the Court. *Id.* Under Section 18-109(b), a plaintiff is required to serve the limited liability company's registered agent, and, if service is made on the Delaware Secretary of State, within seven days after this service the Register in Chancery is to serve the manager by United States registered mail. The HDG Defendants argue that because R&D has not properly effectuated service under Section 18-109(b), R&D has not properly subjected Investment Services to jurisdiction in Delaware under Section 18-109.

Rule 12(b)(5) allows a defendant to seek dismissal on the basis of "insufficiency of service of process." Rule 12(h)(1) waives the lack of personal jurisdiction defense if a party fails to raise it in the initial motion or responsive pleading. "When read in pari materia, the provisions of Rule 12(b) and (h) require that a Rule 12 defense of lack of personal jurisdiction must be raised by a timely Rule 12 motion or, if no motion is filed, in the first responsive pleading. Otherwise, the defense is waived." *Plummer v. Sherman*, 861 A.2d 1238, 1243-44 (Del. 2004).

The HDG Defendants argue that because R&D raised Section 18-109(a) for the first time in its Answering Brief, they could not have asserted a Rule 12(b)(5) argument in their initial motion to

a. *Section 18-109(a)(i)*

Section 18-109(a)(i) identifies the managers of a Delaware limited liability company by reference to Section 18-101(10), which defines a manager as "a person who is named as manager of a limited liability company in, or designated as a manager of a limited liability company pursuant to, a limited liability company agreement or similar instrument under which the limited liability company is formed." The LLC Agreement provides in Section 6.1 that "the management of the business and affairs of the [Joint Venture] shall be vested in a board of directors of the [Joint Venture]."[62] Section 6.1 further states that "[f]or the purposes of the LLC Act, the management of the [Joint Venture] shall be vested in a Manager as defined in the LLC Act and not in the Members" and that "[t]he Manager shall consist of the Board of Directors."[63] Therefore, under Section 18-

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dismiss, and are now entitled to respond with one. The HDG Defendants, however, addressed Section 18-109 in their Opening Brief; that argument sufficiently demonstrates that they were aware that R&D's jurisdictional efforts were not limited to the long-arm statute but could also include Section 18-109. With that knowledge, their failure to raise the sufficiency of service of process defense in their opening papers constitutes a waiver.

[62] LLC Agreement § 6.1.

[63] *Id.* § 6.1. It is perhaps arguable that the LLC Agreement intended to incorporate the definitions of manager from the service of process section of the LLC Act. If so, the question of whether Investment Services participated materially in the management of the Joint Venture is discussed, *infra*.

109(a)(i), the Joint Venture's manager is the Board of Directors.[64] Because Investment Services is not listed in the LLC Agreement as a member of the Joint Venture's Board of Directors, it may not be considered a manager of the Joint Venture for the purposes of either Section 18-109(a)(i) or Section 18-101(10).[65]

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[64] Section 6.4 of the LLC Agreement sets forth the composition of the Board of Directors. LLC Agreement § 6.4.

[65] Section 18-101(10) requires the LLC Agreement to explicitly "name" or "designate" Investment Services as manager to be a Section 18-109(a)(i) manager, which R&D concedes that it does not do. Tr. 39 ("The [LLC Agreement] does not specifically call out [Investment Services] as a manager . . . ."). R&D's attempt to posit an alternative, "functional" definition of manager for the purposes of the Section 18-109(a)(i) and Section 18-101(10), Tr. 39, is unpersuasive.

First, R&D argues that because the Asset Management Agreement provided Investment Services with

> the power to act for the Joint Venture and Group Companies on all matters in material compliance with the Business Plan and the applicable Annual Budget and may enter into agreements (other than any Development Agreement and any agreement for the sale, assignment, transfer, encumbrance, hypothecation, or pledge of any Property or other material asset of any Group Company) for and on behalf of them so long as such actions are materially consistent with the Business Plan and in material compliance with the applicable Annual Budget, Asset Management Agreement § (1)B,

Investment Services counts as a manager of the Joint Venture. AB 11.

While this clause of the Asset Management Agreement gave Investment Services a broad mandate to conduct the Joint Venture's day-to-day operations, Investment Services' role was still limited by having to comply with the Business Plan and the applicable Annual Budget. Nor could Investment Services enter into any agreements transferring property or material assets of the Group Companies. More importantly, this provision of the Asset Management Agreement does not in any way explicitly "name" or "designate" Investment Services as manager, as Section 18-101(10) requires.

Second, R&D argues that Investment Services' role as manager is indicated by the breadth of the Asset Management Agreement's provision that "it is understood by all parties that, to the extent [Investment Services] acts in accordance with, and as limited by, the terms of this

b. *Section 18-109(a)(ii)*

Section 18-109(a)(ii) of the LLC Act also provides that "a person, whether or not a member of a limited liability company, who, although not a manager as defined in § 18-101(10) of this title, participates materially in the management of the limited liability company" can nonetheless be served with process as a manager under Section 18-109(a). R&D argues that given Investment Services' broad authority to act on behalf of the Joint Venture under the Asset Management Agreement, and the fact that it thereby was to run the day-to-day operations of the Joint Venture, Investment Services can be said to have "participated materially" in the management of the Joint Venture.[66]

Agreement, [Investment Services'] actions hereunder are for the account of the respective Group Company." Asset Management Agreement § (6)B. Once again, this provision limits Investment Services to act "in accordance with, and as limited by, the terms of the Agreement," and, again, in no way "names" or "designates" Investment Services as manager as contemplated by Section 18-101(10).

Third, R&D cites the Asset Management Agreement's assignment clause as demonstrating the parties' express intention that the Joint Venture's operations would be "controlled" by an HDG affiliate. AB 5 n.2; Asset Management Agreement § (11). While this intention may be so, the assignment clause, once more, and even when viewed in conjunction with the other cited agreement provisions, does not "name" or "designate" Investment Services as a manager for the purposes of Section 18-101(10).

[66] AB 12.

The Asset Management Agreement specifically provides that Investment Services "is an independent contractor and is not acting as agent, partner, joint venturer, lessee, coprincipal, or associate of any Group Company [including the Joint Venture] or any person claiming by, through or under any Group Company, in the conduct of any Group Company's businesses."[67] As the HDG Defendants note, the fact that the Asset Management Agreement specifies Investment Services' role as an "independent contractor," and that it is "not acting as agent," detracts from R&D's contention that Investment Services had participated materially in the management of the Joint Venture.

Further, under the Asset Management Agreement, the role of Investment Services was confined to acting "as the asset manager and to provide the [listed] Services with respect to the Properties, Assets and Business in a manner consistent with the Business Plan."[68] The management of the underlying assets of an LLC is analytically distinct from the management of the LLC itself for the purposes of Section 18-109(a)(ii). Under the Asset Management Agreement, the discretion and decision-making ability of Investment Services was contractually (and materially)

[67] Asset Management Agreement § (6)B.
[68] *Id.* § (1)A(a).

constrained: for instance, Investment Services (i) had to "act in material compliance with the Business Plan and the applicable Annual Budget," and (ii) could not enter into any "sale, assignment, transfer, encumbrance, hypothecation, or pledge of any Property or other material asset of any Group Company."[69]

The degree of involvement in a limited liability company that constitutes material participation in its management has not been defined with precision.[70] Here, the Asset Management Agreement does give Investment Services relatively broad authority to engage in most of the operation and supervision of the Joint Venture.[71] Yet, the Complaint does not allege—especially in a non-conclusory fashion—that Investment Services actually engaged in any of its contractually

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[69] *Id.* § (1)A(b).

[70] *See* Robert L. Symonds, Jr. & Matthew J. O'Toole, *Symonds & O'Toole on Delaware Limited Liability Companies*, § 9.13 at 9-77 (2012); *see also Ross Hldg. & Mgmt. Co. v. Advance Realty Gp., LLC*, 2010 WL 1838608, at *15 (Del. Ch. Apr. 28, 2010) (noting how "[t]he statute does not offer much in the way of guidance" and concluding that Delaware case law "is only marginally more helpful" in determining what minimum alleged conduct is necessary to find that a party has materially participated in the management of an LLC).

[71] Although the Asset Management Agreement confers Investment Services with a broad mandate to carry out the day-to-day operations of the Joint Venture, its authority was subordinate, subject to the Business Plan, Annual Budget, and limitations on the disposition of assets of the Group Companies.

authorized conduct.[72] Merely having the capacity to participate in management does not constitute material participation in management.[73] The Complaint offers very little, if anything, about Investment Services' actual role in the operation of the Joint Venture. There is an allegation that it maintains the books and records, but that alone does not constitute material participation in the management, especially in light of the designation of the board of directors as the Joint Venture's manager.[74] There are other incidental steps taken by Investment Services that are

[72] In hindsight, the reason for this shortcoming may be based upon R&D's reliance on the long-arm statute, the only means by which it sought to serve Investment Services. Because it did not rely upon the Limited Liability Company Act and its specific service of process provisions when it filed the Complaint, R&D may have thought that there was no need to plead those facts that would have demonstrated the degree to which Investment Services may have exercised its contractual authority.

[73] *See, e.g.*, *Fisk Ventures*, 2008 WL 19611156, at *7-8 (declining to find that a party materially participated in management through the power to appoint members to the LLC's board, even where the party "offer[ed] comments via email to [the] appointed [b]oard representatives," because the agreement expressly provided that "all management powers over the business and affairs of the Company shall be exclusively vested in the board"); *see also Palmer v. Moffat*, 2001 WL 1221749, at *2 (Del. Super. Oct. 10, 2001) (finding that parties did not materially participate in management of the LLC, despite a broad contractual grant to them of the "full, exclusive and complete discretion, power and authority, subject in all cases to the provisions of this Agreement . . . to manage, control, administer and operate the business and affairs of the company . . . [and] to make all decisions affecting such business and affairs," because the agreement specifically provided that "[t]he operations of the Company shall be conducted by the Management Committee . . . [and] all Company decisions shall require the affirmative vote of the majority of the members of the Management Committee").

[74] Moreover, R&D has not alleged that the Joint Venture's books and records are in the possession of Investment Services as part of an effort to thwart R&D's right to inspect the Joint Venture's books and records.

alleged in the Complaint, but those allegations do not demonstrate the control or decision-making role necessary to satisfy the statutory standard for personal jurisdiction.[75] In short, the Complaint does not allege that Investment Services materially participated in the management of the Joint Venture and, accordingly, jurisdiction may not be exercised over it by virtue of Section 18-109(a)(ii). R&D has not met its burden to make a *prima facie* showing of a statutory basis for personal jurisdiction over Investment Services under either Delaware's long-arm statute or Section 18-109 of the LLC Act.[76] Therefore, R&D's claim against Investment Services must be dismissed under Rule 12(b)(2) for lack of personal jurisdiction.

[75] It seems unlikely that a party who is alleged to have acted solely as a rental agent would be considered to be materially participating in management of the limited liability company that owned the rental property. The Complaint offers few allegations of fact as to what Investment Services may have done for the Joint Venture that would allow the Court to distinguish Investment Services from that of a mere rental agent. Certainly the powers conferred by the Asset Management Agreement, if those powers were in fact broadly and routinely carried out, would create an interesting question of whether they constituted sufficient participation to be viewed as "material participation." Without those additional allegations in the Complaint, however, this hypothetical is a question which the Court need not, and should not, resolve.

[76] Because the Court finds no statutory jurisdiction, it need not consider whether the exercise of that jurisdiction would satisfy due process.

C. *Jurisdiction over HDG Properties*

As with Investment Services, R&D bears the burden of making a showing that the Court has jurisdiction over HDG Properties relating to its books and records request. R&D's sole allegation is that HDG Properties consented to the jurisdiction of the Delaware courts in the LLC Agreement "[w]ith respect to any legal actions or proceedings arising out of or in connection with [the LLC] Agreement."[77] As R&D correctly notes, "[a] party may expressly consent to jurisdiction by contract," and "[i]f a party properly consents to personal jurisdiction by contract, a minimum contacts analysis is not required."[78]

R&D's claim here has a definite nexus to the LLC Agreement. That agreement confers certain rights upon R&D to inspect the Joint Venture's books and records. It may be that R&D has no claim against HDG Properties, but that is an issue to be reviewed under Court of Chancery Rule 12(b)(6), not Rule 12(b)(2). Thus, the Court does have jurisdiction over HDG Properties because of its contractual consent.

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[77] LLC Agreement § 22.2.
[78] *Ruggiero*, 948 A.2d at 1132 (citing *Capital Gp. Cos. v. Armour*, 2004 WL 2521295, at *2 (Del. Ch. Oct. 29, 2004)).

D. *Does the Complaint State a Claim Against the HDG Defendants Other than Investment Services?*

R&D has not identified any source—either the LLC Act or the LLC Agreement—for a right to inspect records allegedly held by other members (or contracting parties) of the Joint Venture. R&D has not alleged that any of the HDG Defendants, except for Investment Services, has possession or control of the books and records which it seeks. It has not alleged, even if all reasonable inferences are drawn in its favor, that the LLC Act entitles it to inspect the books and records of other members or parties affiliated with other members. Thus, R&D has failed to allege any "reasonably conceivable" collection of facts upon which it could prevail against these other HDG Defendants.[79] It necessarily follows that R&D's inspection claims against these HDG Defendants must be dismissed under Rule 12(b)(6) because of R&D's failure to state a claim upon which relief can be granted.[80]

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[79] *See Cent. Mortg. Co.*, 27 A.3d at 537.

[80] This case is unusual because R&D owns an 87% interest in the Joint Venture. It is atypical for such a majority owner to invoke its books and records inspection rights, especially in such an attenuated fashion. Perhaps the Joint Venture has its own rights that it may assert directly against one or more of the HDG Defendants in order to gain access to the books and records which R&D has identified.

IV. CONCLUSION

For the foregoing reasons, the Court does not have personal jurisdiction over Investment Services. The Complaint does not state a claim upon which relief can be granted against the other HDG Defendants. Thus, the motion to dismiss will be granted as to all of the HDG Defendants.[81]

IT IS SO ORDERED.

Very truly yours,

/s/ John W. Noble

JWN/cap
cc: Register in Chancery-K

[81] The Court does not need to reach the question of whether R&D alleged a proper purpose in support of its inspection demand.