IN THE SUPERIOR COURT OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

TODD ALBERT, *et. al.*,	)	
Plaintiffs,	)	
v.	)	C.A. No. 04C-05-250 PLA
ALEX. BROWN MANAGEMENT SERVICES, INC., *et. al.*,	)	
Defendants.	)	
ELIZABETH BAKER, *et. al.*,	)	
Plaintiffs	)	
v.	)	C.A. No. 04C-05-251 PLA
ALEX. BROWN MANAGEMENT SERVICES, INC., *et. al.*,	)	
Defendants.	)	

Submitted: July 26, 2004
Decided: September 15, 2004

UPON DEFENDANTS' MOTION TO DISMISS
AND/OR TO
TRANSFER TO THE COURT OF CHANCERY
GRANTED

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ABLEMAN, JUDGE

Plaintiffs, who are limited partners of two Delaware Limited Partnerships, have sued the General Partners and their alleged successors, agents, principals, and co-conspirators for fraud, negligence, and breach of the Limited Partnership Agreements ("LP Agreements"). On Defendants' joint motion to dismiss for lack of subject matter jurisdiction, or in the alternative to transfer to the Chancery Court, the Court finds that the Plaintiffs have stated only equitable claims within Chancery Court's jurisdiction. Defendants' Motion To Dismiss is therefore **GRANTED**.

I. Statement of Facts

A. The Parties

Each of the 73 Plaintiffs invested at least a million dollars worth of stock into two exchange funds, DB Alex. Brown Exchange Fund I, L.P. ("Fund I") and DB Alex. Brown Exchange Fund II, L.P. ("Fund II," collectively "the Funds"). Both Funds are Delaware limited partnerships. Defendant Alex. Brown Management Services, Inc. ("ABMS"), a Maryland corporation, was the general partner of Fund I, while Defendant DC Investment Partners, LLC ("DCIP"), a Tennessee limited liability company, was the general partner of Fund II. ABMS was wholly owned by Alex. Brown, Inc., which was subsequently acquired by Bankers Trust New York Corporation, which was then acquired by Deutsche Bank. Several subsidiaries of Alex. Brown and Deutsche Bank allegedly participated in

managing the Funds and are also defendants, as are numerous members of the Funds' Management Committees.

B. Exchange Funds

The purpose of an exchange fund is to provide portfolio diversity to those holding substantial wealth in the form of unrealized capital gains. The common way to achieve a diversified portfolio is to buy holdings in multiple investment sectors, thereby cushioning the negative impact that a decline in any one sector or stock can inflict. However, if a single stock represents most of one's wealth, the only means to procure funds to buy diverse holdings is to sell that stock, thereby realizing an unwanted taxable capital gain. An exchange fund is specifically designed to prevent such tax consequences.

Exchange funds work by convincing investors to trade large blocks of stock, usually one million dollars worth or more, for units in the exchange fund itself. Thus, instead of owning one large block of one stock, each investor owns a percentage interest in many types of stock contributed by all the investors. The IRS does not consider the trade a realized capital gain so long as the fund meets certain requirements. A properly managed fund lures in many different kinds of stock and then carefully screens them to make sure that its portfolio is diverse enough to weather economic downturns. If investors decide that they want to sell stock, they may trade back their units and withdraw from the fund at predetermined intervals.

C. Hedging And The Internet Bubble

A large percentage of individuals who needed the services of an exchange fund in the late 1990's were internet millionaires, who acquired their wealth by founding or working for startup companies. Accordingly, a disproportionate percentage of applicants to the Funds wanted to contribute stock in telecommunications and technology companies, rather than more traditional industry sectors. The Complaint alleges that the Defendants failed to properly screen applicants to insure that the Funds' portfolios were diversified. Instead, the Funds allegedly took about 70% of their contributed stock from the telecommunications and technology sectors, commonly known to be the most volatile on the market.

One serious investment concern is hedging, or protecting against a decrease in a stock's value. A common way to hedge stock is to "collar" it by selling a call option and buying a put option. The call option requires one to sell stock at a certain price, always above the current trading price, while the put option allows one to force another to buy it at a certain price, always below the current trading price, thereby locking the risk between the two prices. Since the put option is purchased with the proceeds from selling the call option, collaring can be a low cost way to reduce exposure to volatility.

When a stock rises above the strike price of a call option, its owner usually sells the stock as promised. However, an exchange fund, whose sole purpose is to avoid selling stock so that its investors avoid capital gains taxes, cannot sell stock that rises to the strike price. Instead, exchange funds make up for their failure to sell as promised by paying cash. If portfolio advances significantly outweigh declines, an exchange fund using the collar technique will find itself hemorrhaging cash.

This is precisely what happened to the Funds during the internet bubble run-up from 1997 to 2000. As internet stocks soared, the tech heavy Funds found that they had collared their way into a liquidity crisis. This allegedly led the Funds in early 2000 to abandon hedging altogether. Just a month or so later, the internet bubble burst, sending tech stocks plummeting and racking up huge losses for the then unhedged, unprotected Funds.

D. The Claims

Plaintiffs claim that the Funds misrepresented that they were screened to insure diversity, properly hedged, and actively and professionally managed. This "fraud," according to Plaintiffs, was intended to and actually did keep them from exercising their option to withdraw from the Funds so that the Defendants would keep earning management fees. The Plaintiffs further allege that the Funds' failure to diversify, hedge, and keep them informed breached the LP Agreements and was

grossly negligent, resulting in the Defendants' unjust enrichment. Plaintiffs seek punitive damages for this alleged fraud and recklessness. The Defendants, other than ABMS and DCIP, are alleged to have aided and abetted the misconduct or profited by it through agency or successor relationship. Defendants believe these claims to be either equitable or related to the Delaware Revised Uniform Limited Partnership Act ("DRULPA"), and therefore within the sole jurisdiction of Chancery Court. They seek to transfer the case there or dismiss it.

II. Discussion

I begin by noting that it is absolutely clear that the Court of Chancery has, at minimum, concurrent jurisdiction over these claims. While the Plaintiffs have been exceedingly careful to couch the Complaint in common law language, the most cursory examination indicates that this is, at heart, an action for breach of fiduciary duty, the likes of which Chancery Court considers routinely. Plaintiff's negligence allegation is more aptly stated as breach of the duty of care. The fraud claim is a perfect analogue for breach of the duty of disclosure. Plaintiffs' proposed motive, that the Defendants failed to act in Plaintiffs' interest because they were more interested in fee income, is a classic duty of loyalty claim. The question therefore is not if this Court may transfer the case to Chancery, but whether it should, thus depriving the Plaintiffs of a jury trial and a chance to reap punitive damages. Because of the equitable nature of these claims and their

bearing on the internal relations of two Delaware limited partnerships, I hold that transfer is appropriate.

A. In Delaware, Clever Pleading Opens No Doors

As already noted, Plaintiffs have scrupulously avoided using the words "breach of fiduciary duty" to describe Defendants' conduct, though their brief does not deny that this characterization is apt. That avails them nothing, however, because Delaware courts look beyond mere form to the substance of the pleadings when determining subject matter jurisdiction:

> [T]he question as to whether or not equitable jurisdiction exists is to be determined by an examination of the allegations of the complaint viewed in light of what the plaintiff really seeks to gain by bringing his cause of action. … [T]he established rule [is] that the prayers of a complaint do not rigidly control this Court's inquiry into [w]hat it is that a plaintiff really seeks in filing a complaint and that this Court should, when required, go behind a facade of prayers in order to determine whether the relief sought is in fact equitable or legal.[1]

Normally it is the Court of Chancery that is forced to ferret out parties who cloak legal claims in equitable language. These parties may be seeking to intimidate their opponents with the prospect of equitable remedies to which they are not entitled, or to take advantage of Chancery's sharper corporate expertise and faster moving docket. However, Plaintiffs have not offered, nor have I found, any reason that the Superior Court should be any less concerned with equitable claims masquerading as legal ones. Indeed, the prospect of litigating a complex corporate

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[1] *Hughes Tool Co. v. Fawcett Publications, Inc.*, 297 A.2d 428, 431-2 (Del. Ch. 1972.), *rev'd on other grounds,* 315 A.2d 577 (Del.1974) (internal citations omitted).

equitable claim in a jury trial, away from the expertise and context that Chancery can uniquely provide, likely has a greater *in terrorem* effect. When there is no real expectation of a right to or a desire for trial by jury, this *in terrorem* filing seems meant only to drive up the cost of litigation as leverage for settlement negotiations.[2] Such tactics are patently unfair.

B. Almost All Breaches Of Fiduciary Duty Are Frauds, But They Still Belong In Chancery Court.

In deciding this motion, this Court was fortunate that Vice Chancellor Strine had already discerned three-quarters of the answer in his thoughtful opinion in *Metro Communication Corp. BVI, v. Advanced Mobilecomm Technologies Inc*.[3] To oversimplify a complicated case, *Mobilecomm* involved a LLC whose business required making frequent capital calls to its investors. The investors alleged that disclosures from the board over a long period were misleading and caused them to respond to numerous capital calls when they otherwise would not have done so. They alleged that these mis-disclosures constituted both common law fraud and breach of fiduciary duty. The defendants realized that the two claims would require proof of the same level of culpability, and thus did not waste time moving

[2] *Supra Part II.C.4.*
[3] 2004 WL 1043728 (Del. Ch. Apr. 30, 2004).

to dismiss the common law fraud claim.[4] They did, however, contest an equitable fraud claim also included in the complaint.

Vice Chancellor Strine noted that,

> The intertwining of fraud and fiduciary concepts in this context should surprise no one. There is an obvious and important reason for the overlap: Delaware's law of fiduciary duty is itself an aspect of our common law. As such, it is unsurprising that our law of fiduciary duty has evolved to the point in which there are specific standards that govern the liability of entity fiduciaries, such as managers of LLCs or more commonly corporate directors, for disclosures or non-disclosures to entity owners. When Delaware courts refine these standards - essentially specialized common law and equitable fraud rules for fiduciaries - they must take into account context-specific policy concerns.[5]

The Vice Chancellor reasoned that these refinements to fraud liability in the context of fiduciary duties were both intentional and valuable as an embodiment of Delaware's strong policy to let the managers of corporate entities run them with minimal judicial second-guessing. In so doing, he noted:

> I believe it would undermine the effective operation of LLCs like Fidelity Brazil for this common arrangement to come with a judicially encrusted requirement that the LLC managers provide proxy-statement-like disclosures each time they make a capital call. This would be inefficient and would threaten to convert the duty to disclose all material facts in connection with a discretionary vote or tender into a pervasive, across-the-board rule governing all entity disclosures, because entity owners can usually connect any disclosure to a decision they might make (e.g., the decision whether to hold or sell their ownership interests).[6]

While the Plaintiffs in this case have pled legal, rather than equitable, fraud, the concern is the same. The court that decides this case must determine whether the Funds' disclosures were insufficient or misleading, and, if so, whether and to what degree that matters. This requires reference to "specialized fraud rules for

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[4] *Id.* at 21.

fiduciaries" that depend on timing and context. The Plaintiffs, however, would prefer that this Court (or worse, a jury) ignore decades of scalpel-precise legal development in favor of clumsily machete-ing its way through the case with the same common law fraud standard that would apply to non-fiduciaries. I cannot agree that Delaware law requires me to do so, simply because, unlike the *Mobilecomm* plaintiffs, the Plaintiffs here have cleverly avoided mentioning the words "fiduciary duty."

C. Even If The Allegations Were Not Disguised Fiduciary Duty Claims, They Still Invoke The Sole Jurisdiction Of Chancery

Stripping away the layers of agency/successor and accomplice liability, Plaintiffs offer four substantive bases for relief: fraud, breach of contract, negligence, and unjust enrichment. To begin with the most obvious, unjust enrichment is a purely equitable matter solely within Chancery Court's jurisdiction.[7] Indeed, its *raison d'être* is that actions at law sometimes produce an unjust result that equity will not abide.[8] I deal with the remaining issues as follows:

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[5] *Id.* at 22.
[6] *Id*. at 22.
[7] *Fleer Corp. v. Topps Chewing Gum, Inc*., Del. Supr., 539 A.2d 1060, 1062 (1988)
[8] *Id, citing* 66 Am.Jur.2d, *Restitution and Implied Contracts* § 3, p. 945 (1973) ("Unjust enrichment is defined as the unjust retention of a benefit to the loss of another, or the retention of money or property of another against the fundamental principles of justice or equity and good conscience.") (internal quotation marks omitted).

1. Breach Of Contract[9]

Delaware Revised Uniform Limited Partnership Act ("DRULPA") § 17-111 provides:

> Any action to interpret, apply or enforce the provisions of a partnership agreement, or the duties, obligations or liabilities of a limited partnership to the partners of the limited partnership, or the duties, obligations, or liabilities among partners or of partners to the limited partnership, or the rights or powers of, or restriction on, the limited partnership or partners, may be brought in the Court of Chancery.

Defendants argue, and this Court agrees, that the breach of contract issues presented here fall under § 17-111. The crux of the contract claims is that ABMS and DCIP had a duty to diversify, hedge, and manage the Funds, and that they failed to adequately do so. This duty arises from the LP Agreements, requiring a court "to interpret, apply or enforce the provisions of a partnership agreement" within the meaning of § 17-111.

The real question is whether the word "may" grants Chancery Court exclusive jurisdiction over § 17-111 actions, or merely concurrent jurisdiction with the Superior Court. The law on the subject is rather murky, and neither side has been able to cite a case directly on point.

Defendants cite *Boone v. Howard* for the proposition that, "The general rule is that Chancery Court, not Superior Court, has jurisdiction over litigation of

[9] Plaintiffs' Third Claim is that ABMS breached the LP Agreements by failing to properly diversify, hedge, and manage the Funds as outlined therein. Plaintiffs' Fourth Claim is that the Defendants never intended to follow through on those promises, thus breaching the covenant of good faith and fair dealing implied in every contract.

matters arising out of partnership affairs. Superior Court does have jurisdiction once there has been an accounting or settlement of the partnership affairs."[10] Judge [now Chief Justice] Steele based this rule statement on *Mack v. White*, a 1933 case holding this rule to be "so well established that it should require no citation of authorities."[11] Unfortunately, *Boone* and its progeny do not discuss when, or more importantly when not, to apply the general rule, besides after an accounting. *Mack* details one other exception to support Superior Court jurisdiction, that being when partners evince intent to segregate business out of the partnership by creating a separate instrument, such as a promissory note.[12]

Plaintiffs cite two cases to show that Superior Court holds concurrent jurisdiction under § 17-111. In the first, *Verlaque v. Charles A. Zonko Builder, Inc.*, the Superior Court retained jurisdiction over claims that involved separately executed instruments between partners, a promissory note and a construction contract.[13] This decision fits squarely into the *Mack* exception. The *Verlaque* court accepted the general rule and dismissed the four claims that were not based on a separate instrument.[14]

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[10] *Boone v. Howard*, 1989 WL 124898 (Del. Super. 1989) at *6; *citing Mack v. White*, 165 A. 150 (1933); *accord Lost Creek Land and Cattle Co., Inc. v. Wilson*, 2002 WL 31478004 (Del. Super. 2002) at *2.

[11] *Mack*, 165 A. at 150, but *Mack* does provide several 19th century decisions for support.

[12] *Id*. at 151-2.

[13] 1989 WL 112029 (Del. Super. 1989).

[14] *Id*. at *4.

Plaintiffs' other case, *Snyder v. Butcher & Company*[15], is more convincing. The plaintiff in *Snyder* had alleged both equitable and legal fraud. The court detailed the difference between the two, and then maintained jurisdiction over the legal fraud even though no accounting had yet occurred. Judge Goldstein seems to have accepted the plaintiff's argument that common law fraud remains a legal action even in the context of one partner suing another before an accounting. To some degree, *Snyder* involved interpreting duties under a limited partnership agreement per § 17-111; the basis for the fraud claim was that the defendant remained silent when he had a fiduciary obligation, created by the agreement, to speak. It is significant, however, that § 17-111 was not yet law when *Snyder* was decided.

Considering these cases together, it appears that Delaware courts have consistently interpreted § 17-111 as maintaining the former rule that Chancery has sole jurisdiction over internal partnership affairs, except after some event has occurred, such as an accounting or drafting a separate instrument, that obviates equity's superior ability to resolve all outstanding matters between the parties. This makes sense in light of the fact that disputes between partners will almost always involve equitable issues. It also enhances Delaware's attractiveness as a home for partnerships by providing managers of those entities with a secure, highly

[15] 1992 WL 240344 (Del. Super. 1992).

expert forum to resolve disputes involving how they do their jobs. I credit the relatively minimal extent that *Snyder* deviated from this rule to ambiguity that has since been cleared by the enactment of § 17-111 and subsequent cases.

Because DRULPA § 17-111 rests jurisdiction for interpreting partnership agreements in Chancery barring some exception not present here, I conclude that this Court lacks subject matter jurisdiction over Plaintiffs' breach of contract claims. Transfer to Chancery Court is therefore required.

2. Fraud and Negligence

The same logic that compels me to transfer the breach of contract claims applies equally to the fraud and negligence claims. The duty that the Plaintiffs must prove the Defendants breached is that which the LP Agreements impose; there is no other basis for relief. To determine the scope of this duty is to interpret the LP Agreements, and thus invoke Chancery's primary jurisdiction under § 17-111.

The reasons for transferring the negligence claim are the most pronounced. As noted *ante Part II.B*, a claim that a corporate manager acted with gross negligence is the same as a claim that she breached her fiduciary duty of care.[16] Delaware permits business organizations, including limited partnerships, broad

[16] *McMullin v. Beran*, 756 A.2d 910, 921 (Del. 2000); *quoting Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) ("Director liability for breaching the duty of care 'is predicated upon concepts of gross negligence.'")

discretion to eliminate, through contract, liability for breach of the duty of care. Finding for the Plaintiffs here would mean that investors could lure in top managers with such liability waivers, then later completely disregard the waivers by choosing to sue in Superior Court for negligence. This would thwart the General Assembly's intent in enacting such statutes, 8 *Del. C.* § 102(b)(7) being the most obvious, and rob Delaware of the net gains that those provisions create. Unless I am gravely mistaken, that cannot be the law.

3. The Ancillary Claims

Without the substantive allegations already discussed, Plaintiffs' ancillary claims for agency, successor, and conspirator liability must also be transferred to Chancery. These claims all involve abetting or profiting from breaches of the LP Agreements, and the existence and scope of those breaches should be properly determined in Chancery.

4. Jury And Punitive Damages

Finally, I note that the two reasons offered for maintaining jurisdiction in this case, the Plaintiffs' right to a jury trial and to seek punitive damages, are not particularly compelling on these facts. I find it difficult to believe that the Plaintiffs really want a jury trial. This case involves obscure, complicated investment strategies available only to multi-millionaires and far beyond the ken of the average investor, let alone the average juror. I cannot imagine a schoolteacher

or mechanic juror sympathizing with Plaintiffs who lost part of their many millions in some barely understandable, aristocratic, tax-dodging investment vehicle, during a time period when nearly every stock investor took substantial losses. The jury demand smacks of a tactical bluff rather than a genuine assertion of right.

The punitive damages demand is equally flimsy. While it is true that a fraud allegation can support punitive damages, many types of fraud, including all those involving breach of fiduciary duty, are heard exclusively in Chancery without possibility of punitive damages. Plaintiffs' claims are of that ilk.

III. Conclusion

For the foregoing reasons, this Court finds that the Plaintiffs' have stated only equitable claims within the sole jurisdiction of the Court of Chancery. In addition, Plaintiffs' claims require interpreting limited partnership agreements under circumstances also within the sole jurisdiction of the Court of Chancery. I believe that the simplest way to proceed is to dismiss the case for lack of subject matter jurisdiction.[17] Plaintiffs will then, pursuant to 10 *Del. C.* § 1902[18], have 60

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[17] Plaintiffs will then have an opportunity to amend their complaints, at least to omit the jury demand, during the 60-day transfer period, rather than having to immediately pursue leave to amend in Chancery.

[18] "No civil action, suit or other proceeding brought in any court of this State shall be dismissed solely on the ground that such court is without jurisdiction of the subject matter, either in the original proceeding or on appeal. Such proceeding may be transferred to an appropriate court for hearing and determination, provided that the party otherwise adversely affected, within 60 days after the order denying the jurisdiction of the first court has become final, files in that court a written election of transfer, discharges all costs accrued in the first court, and makes the usual deposit for costs in the second court. All or part of the papers filed, or copies thereof, and a transcript of the entries, in the court where the proceeding was originally instituted shall be

days to file the appropriate documents to transfer the case to the Court of Chancery. Defendants' Motion To Dismiss is hereby **GRANTED**.

IT IS SO ORDERED.

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Peggy L. Ableman, Judge

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delivered in accordance with the rules or special orders of such court, by the Prothonotary, clerk, or register of that court to the Prothonotary, clerk or register of the court to which the proceeding is transferred. The latter court shall thereupon entertain such applications in the proceeding as conform to law and to the rules and practice of such court, and may by rule or special order provide for amendments in pleadings and for all other matters concerning the course of procedure for hearing and determining the cause as justice may require. For the purpose of laches or of any statute of limitations, the time of bringing the proceeding shall be deemed to be the time when it was brought in the first court. This section shall be liberally construed to permit and facilitate transfers of proceedings between the courts of this State in the interests of justice."