IN THE SUPREME COURT OF THE STATE OF DELAWARE

DV REALTY ADVISORS LLC,	§	
	§	No. 547, 2012
Defendant Below,	§	
Appellant,	§	Court Below – Court of Chancery
	§	of the State of Delaware
v.	§	C.A. No. 7204
	§	
POLICEMEN'S ANNUITY AND	§	
BENEFIT FUND OF CHICAGO,	§	
ILLINOIS, MUNICIPAL	§	
EMPLOYEES' ANNUITY AND	§	
BENEFIT FUND OF CHICAGO,	§	
LABORERS' AND RETIREMENT	§	
BOARD EMPLOYEES' ANNUITY	§	
AND BENEFIT FUND OF	§	
CHICAGO, RETIREMENT PLAN	§	
FOR CHICAGO TRANSIT	§	
AUTHORITY EMPLOYEES'	§	
TRUST, and PUBLIC SCHOOL	§	
TEACHERS' PENSION AND	§	
RETIREMENT FUND OF	§	
CHICAGO,	§	
	§	
Plaintiffs Below,	§	
Appellees.	§	

Submitted: June 4, 2013
Decided: August 26, 2013

Before **STEELE**, Chief Justice, **HOLLAND**, **BERGER**, **JACOBS** and **RIDGELY**, Justices (constituting the Court *en Banc*).

Upon appeal from the Court of Chancery. **AFFIRMED**.

Richard L. Renck, Esquire and Andrew D. Cordo, Esquire, Ashby & Geddes, Wilmington, Delaware, Edward T. Joyce, Esquire and Robert Carroll, Esquire, Edward T. Joyce & Associates, P.C., Chicago, Illinois, for appellant.

Bradley R. Aronstam, Esquire and S. Michael Sirkin, Esquire, Seitz, Ross, Aronstam & Moritz, LLP, Wilmington, Delaware, and William Lynch Schaller, Esquire, John M. Murphy, Esquire and Peter P. Tomczak, Esquire, Baker & McKenzie, LLP, Chicago, Illinois, for appellees.

HOLLAND, Justice:

The defendant-appellant, DV Realty Advisors LLC ("DV Realty"), appeals from the Court of Chancery's declaratory judgment that the plaintiffs-appellees[1] properly removed DV Realty as the General Partner of Chicago-based Delaware limited partnership DV Urban Realty Partners I L.P. (the "Limited Partnership").

DV Realty raises two issues on appeal: first, that the Court of Chancery improperly found that the Limited Partners believed in good faith that, because of untimely delivered audited financial statements, removing DV Realty was necessary for the best interest of the partnership; and, second, that the "Red Flag Issues" raised by an advisor to the Limited Partnership were not sufficient to support a finding that the Limited Partners removed DV Realty in good faith.

We have concluded that both of DV Realty's arguments are without merit. Therefore, the judgment of the Court of Chancery must be affirmed.

[1] The plaintiffs-appellees consist of Policemen's Annuity and Benefit Fund of Chicago, Illinois ("Policemen's Fund"), Municipal Employees' Annuity and Benefit Fund of Chicago ("Municipal Fund"), Laborers' and Retirement Board Employees' Annuity and Benefit Fund of Chicago ("Laborers' Fund"), Retirement Plan for Chicago Transit Authority Employees' Trust ("CTA Fund"), and Public School Teachers' Pension and Retirement Fund of Chicago ("Teachers' Fund") (collectively the "Limited Partners").

The Parties[2]

The Limited Partnership is a Chicago-based Delaware limited partnership that invests in residential and commercial real estate in Chicago. The Limited Partners, DV Realty, and Occam-DV, entered into the Limited Partnership Agreement ("LPA"). The LPA provides the General Partners, and the Managing Partner in particular, with broad discretion to manage the everyday affairs of the Limited Partnership.

Managing Partner DV Realty, a General Partner of the Limited Partnership since 2006, owns 4.9% of the Limited Partnership interests. Jared Davis is the manager of JCJ Family LLC, which is the sole member of DV Realty. Allison Davis, Jared Davis' father, is active in the management of JCJ Family LLC. Non-party Occam-DV was named a General Partner alongside Managing Partner DV Realty. Robert Vanecko ("Vanecko") was the manager of Occam-DV.

The Limited Partners are all public pension funds located in Chicago, Illinois. Collectively, the Limited Partners own 95.1% of the Limited Partnership interests. Among the Limited Partners are Policemen's Fund, with John Gallagher as Executive Director; Municipal Fund, with James

[2] The relevant facts are not in dispute. Unless otherwise noted, the facts are drawn from the Court of Chancery's 2012 memorandum opinion, *Policemen's Annuity & Benefit Fund of Chicago v. DV Realty Advisors LLC*, 2012 WL 3548206 (Del. Ch. Aug. 16, 2012).

Mohler as Executive Director; Laborers' Fund, with James Capasso as Executive Director; CTA Fund, with John Kallianis as Executive Director; and Teachers' Fund, with Kevin Huber as Executive Director.

The LPA

This appeal necessitates our review of four sections of the LPA. Under section 6.1 of the LPA, the General Partners are required to establish an Advisory Committee. Pursuant to section 6.1 of the LPA, an Advisory Committee was formed, which consisted of three members: Blake Eagle, Tariq Malhance, and Steven Rogers. In July, 2007, Rogers resigned but was never replaced. Under section 11.5 of the LPA, the General Partners are also required to provide the Limited Partners with annual audited financial statements. Section 3.2 of the LPA prohibits the use of placement or finder's fees with respect to any of the Limited Partnership's investments. And, section 3.10 specifies the mechanism through which the General Partners can be removed.

The Limited Partners Become Concerned

Beginning in 2007 and continuing until the summer of 2009, certain *Chicago Sun-Times* articles speculated that Vanecko had improperly used his relationship with his uncle and former Chicago mayor Richard Daley to induce the Limited Partners to invest in the Limited Partnership. A grand

jury in the United States District Court for the Northern District of Illinois issued subpoenas to the Limited Partners. The subpoenas demanded "any and all information relating to the investments and/or considerations of investments made . . . [in the Limited Partnership]." At the time of trial, no public information relating to the subject of the investigation had been released.

In June, 2009, the General Partners—DV Realty and Occam-DV—had not yet provided the Limited Partners with audited financial statements for the Fiscal Year 2008 (the "2008 Statements"). These statements were due by April 30, 2009. The Executive Directors of the various Funds constituting the Limited Partners—Gallagher, Mohler, Capasso, Kallianis, and Huber (collectively "Executive Directors")—met to discuss their resulting frustration. Mohler sent an e-mail to the Managing Partners on behalf of the Limited Partners, telling the Managing Partners that under the LPA, the 2008 Statements were due on April 30, 2009. Mohler requested that the Managing Partners immediately notify the Limited Partners when the 2008 Statements would be completed.

In a June 8, 2009 letter, the General Partners informed the Limited Partners that Occam-DV and Vanecko would end their involvement in the Limited Partnership. Vanecko was withdrawing because of alleged

mischaracterizations in the press of his involvement with the Limited Partnership. Vanecko opined that his withdrawal would "further the important work of the [Limited] Partnership while minimizing unwarranted distractions from our core purpose."

Despite Mohler's June 5, 2009 e-mail, the 2008 Statements were not completed by August of 2009. On August 25, 2009, four of the Executive Directors sent DV Realty, now the sole General Partner, a letter requesting the 2008 Statements and information relating to the terms of Vanecko's severance. The letter also requested that DV Realty cooperate with each of the Limited Partner's respective consulting firms. The letter warned that continued failure to resolve these issues "may prompt the limited partners to seek remedies available within the limited partnership agreement."

In a September 9, 2009 letter, DV Realty responded to the Limited Partner's renewed request for the 2008 Statements. DV Realty explained that the delay in providing the 2008 Statements centered on the near term expiration of two loans. The Limited Partnership's auditor, Deloitte & Touche LLP ("Deloitte"), had insisted that "unless these loans were extended, our audit would have a 'going concern' note which is not desirable." DV Realty explained that since it was in the Limited Partnership's interest to not issue an audited statement containing a 'going

concern' note, the 2008 Statements had been delayed. The letter also explained that Vanecko was not paid in connection with his resignation. DV Realty assured the Limited Partners that it would cooperate with the consulting firms. On October 14, 2009, DV Realty provided the Limited Partners with the 2008 Statements—173 days after the due date as required by section 11.5 of the LPA.

The Advisory Committee, long defunct, stopped meeting in late 2009 or early 2010. Malhance resigned from the committee in 2010 and Eagle resigned in 2011. Also in late 2009 or early 2010, Heitman LLC was engaged by the Limited Partnership to provide economic advice.

In April, 2010, Michael Dudek filed suit against the Limited Partnership, DV Realty, and all of the Limited Partners, alleging that he was entitled to a finder's fee because of the Limited Partners' investment in the Limited Partnership. The Limited Partners and the Limited Partnership were dismissed from the suit, but as of the Court of Chancery's 2012 Memorandum Opinion, the Dudek action was still pending against DV Realty. Dudek produced a written consulting agreement that Vanecko executed and that purported to bind the General Partners to pay Dudek 2% of capital raised from certain investments.

In May of 2010, the Limited Partners were concerned because the 2009 audited financial statements (the "2009 Statements") had not yet been completed. Pursuant to section 11.5 of the LPA, the 2009 Statements were due April 30, 2010. Additionally, Heitman LLC had not yet begun its analysis because DV Realty had yet to sign a confidentiality agreement. The Limited Partners sent DV Realty a letter requesting that DV Realty complete the 2009 Statements by June 14, 2010 and that DV Realty cooperate with Heitman LLC by promptly signing a confidentiality agreement.

DV Realty then entered into a confidentiality agreement with Heitman LLC. DV Realty also responded to the Limited Partners' May letter, stating that because of changes in the Financial Accounting Standards, debts that mature within one year of the previous year's audited financial statements would be considered "going concerns." DV Realty explained that three of the Limited Partnership's projects fit into this category, and that if they were not extended or refinanced to provide for a later maturity date, the Limited Partnership's auditor (Deloitte) would include a "going concern" note in the 2009 Statements.

DV Realty stressed that if the 2009 Statements contained a "going concern" note, this would alarm the Limited Partnership's lenders and creditors. DV Realty stated, "[o]ur goal is to have a 'clean' audit issued

which does not impair our relationship with you, our lenders, creditors, or third parties." DV Realty concluded by advising that after conferring with Deloitte and Heitman LLC, they both agreed that August 1, 2010 would be a realistic due date for the 2009 Statements.

As of September 14, 2010, DV Realty still had not completed the 2009 Statements. DV Realty informed Mohler that the Limited Partnership's accountant, RSM McGladrey, Inc. ("RSM"), would prepare a written statement outlining the status of the audit and the expected date of completion. The following day, each Limited Partner received a memorandum from RSM, which explained that all work on the 2009 Statements had been completed except for the "going concern" documentation.

According to RSM, DV Realty was waiting on loan extensions to be completed so that the 2009 Statements could avoid including a "going concern" note. The RSM memorandum explained that Deloitte had requested additional information from DV Realty. The memorandum required DV Realty to provide an updated Debt Assessment Summary, a detailed property cash flow plan, and an assessment of agreements implicating the assertion that the debt instruments do not have fund level recourse or other "going concern" implications.

General Partner Removed

Concerned about the RSM letter, Huber asked Rob Kochis of the Townsend Group Inc. ("Townsend") to offer his "take" on the situation. Townsend had already been retained by the Teachers' Fund to help oversee its real estate investments. Kochis prepared, but did not send, a letter that recommended a change of management. At a September 27, 2010 meeting of Townsend's advisory investment committee, Kochis voiced his recommendation that DV Realty be removed as General Partner of the Limited Partnership. The minutes of the meeting state that Kochis "was critical of [DV Realty's] poor performance, misuse of leverage, lack of transparency, etc."

Kochis sent a letter to Huber that, while not explicitly recommending removal of DV Realty, stated that Townsend believed there were sufficient grounds to terminate DV Realty as General Partner. At trial, Huber denied that he asked Kochis for a recommendation that DV Realty be removed. Huber claims that he and Kochis were merely exploring options.

In November, 2010, Huber called a meeting of the Executive Directors. At this meeting, Huber outlined the pros and cons of removing DV Realty. The Limited Partners collectively engaged Townsend to evaluate the Limited Partnership and to review potential courses of action

with regard to DV Realty. Townsend's mandate included searching for a replacement manager to assume investment management responsibilities for the Limited Partnership.

DV Realty completed the 2009 Statements on March 9, 2011—313 days after the due date mandated by section 11.5 of the LPA. Deloitte's notes to the 2009 Statements indicated that DV Realty had received a $510,837 development fee in connection with a property that the Limited Partnership never purchased. Townsend issued its final report in May, 2011, which recommended that the Executive Directors of the Limited Partners remove DV Realty as General Partner and appoint a successor. Townsend's final report recommended Lincoln Advisory Group Ltd. as a suitable replacement.

Townsend based its recommendation for removal on the untimely audited financial statements, and on several additional factors (the "Red Flag Issues"). Townsend's recommendation cited (1) the Limited Partnership's poor financial performance, (2) Vanecko's resignation, (3) the dysfunction of the Advisory Committee, (4) the Dudek lawsuit, and (5) DV Realty's use of recourse debt in violation of the LPA. Thereafter, each Limited Partner

approved the removal of DV Realty.[3] The Limited Partners executed a written consent for the removal of DV Realty. As of May, 2012, the audited financial statements for 2010 and 2011 had yet to be completed.

The Limited Partners filed a complaint in the Court of Chancery against DV Realty and against the Limited Partnership, as a nominal defendant. The Limited Partners sought a declaratory judgment that they had validly removed DV Realty. In addition, the Limited Partners requested an award of attorney's fees. DV Realty opposed the declaratory relief, arguing that the removal procedures as set forth in the LPA had not been properly observed.

On August 16, 2012, the Court of Chancery issued a Memorandum Opinion, finding that the Limited Partners had properly removed DV Realty but denied the request for attorney's fees. This appeal followed.

Freedom of Contract

This opinion is the latest decision by this Court interpreting language in limited partnership agreements.[4] Although the limited partnership agreements in all of these cases contain troublesome language, each decision

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[3] The Boards of Trustees of the Policemen's Fund, the Teachers' Fund, the Laborers' Fund, and the Municipal Fund all approved removal. The Board of Trustees of the CTA Fund delegated authority to Kallianis, who approved removal.

[4] *E.g.*, *Allen v. Encore Energy Partners, L.P.*, ___ A.3d ___, 2013 WL 3803977 (Del. July 22, 2013); *Gerber v. Enter. Prods. Hldgs., LLC*, 67 A.3d 400 (Del. 2013); *Norton v. K-Sea Transp. P'rs L.P.*, 67 A.3d 354 (Del. 2013); *Brinckerhoff v. Enbridge Energy Co.*, 67 A.3d 369 (Del. 2013).

was based upon significant nuanced substantive differences among each of the specific limited partnership agreements at issue. That is not surprising, because the Delaware Revised Uniform Limited Partnership Act is intended to give "maximum effect to the principle of freedom of contract."[5] Accordingly, our analysis here must focus on, and examine, the precise language of the LPA that is at issue in this case. Section 3.10(a)(ii) of the LPA provides in pertinent part:

> Both General Partners (and only both, not either General Partner individually) may be removed without Cause by an affirmative vote or consent of the Limited Partners holding in excess of 75% of the [Limited] Partnership Interests then held by all Limited Partners; provided that consenting Limited Partners *in good faith* determine that such removal is necessary for the *best interest* of the [Limited] Partnership. (emphasis added).

Court of Chancery Decision

The Court of Chancery ruled that the Limited Partners bore the burden of proof to demonstrate action in good faith under § 3.10(a)(ii). The Court of Chancery noted that "The LPA . . . does not define good faith, and good faith can sometimes include objective, as well as subjective, elements." Looking to the language of section 3.10(a)(ii), the Court of Chancery found that the term "good faith" was ambiguous.

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[5] *Allen v. Encore Energy Partners, L.P.*, ___ A.3d ___, 2013 WL 3803977, at *4 (Del. July 22, 2013); Del. Code Ann. tit. 6, § 17-1101(c).

To resolve that ambiguity, the Court of Chancery turned to the Uniform Commercial Code ("UCC") definition of good faith found in title 6, section 1-201(20) of the Delaware Code, which states: "'Good faith', except as otherwise provided in Article 5 [which deals with letters of credit], means honesty in fact and the observance of reasonable commercial standards of fair dealing." The Court of Chancery also examined the common law, noting that good faith usually meant subjective good faith, but "there is likely some conduct which is so unreasonable that [the Court of Chancery] will necessarily determine that it could not have been undertaken in good faith."[6] The Court of Chancery decided to use the UCC definition of "good faith" because it was "at least" as broad as the common law definition.

The Court of Chancery then concluded that the Limited Partners determined in good faith that the removal of DV Realty was "necessary for the best interest of the Limited Partnership." The court found that the Limited Partners had removed DV Realty in subjective good faith:

> Ultimately, the court determines that the Policemen's Fund, the Teachers' Fund, the Laborers' Fund, and the Municipal Fund have shown that [DV Realty's] continuous failure to have the Limited Partnership's audited [f]inancial statements completed in the time prescribed by Section 11.5 provided them with a good faith belief that [DV Realty] needed to be removed for the best interest of the Limited Partnership.

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[6] *See Guttman v. Huang*, 823 A.2d 492, 506 n.34 (Del. Ch. 2003) (explaining that conduct undertaken in subjective good faith may nonetheless be impermissible).

The Court of Chancery also found that it was objectively reasonable for the Limited Partners to believe that it was necessary in the best interest of the Limited Partnership for DV Realty to provide timely audited financial statements. The court explained:

> Annual audited financial statements provide significant value to a business. Thus, when a limited partnership agreement places, on a general partner, the duty of having the limited partnership's audited financials completed by a specific time, and the general partner consistently fails to meet that duty, it is objectively reasonable to believe that [it] is necessary in the best interest of the limited partnership to replace that general partner.

Thus, the Court of Chancery held the Limited Partners acted in good faith, both subjectively and objectively, and therefore complied with the requirements of section 3.10(a)(ii).

Standard of Review

DV Realty contends that, as a matter of law, its failure to provide timely audited financial statements did not afford the Limited Partners a good faith basis to believe that removing DV Realty was "necessary for the best interest of the partnership." We review the Court of Chancery's conclusions of law *de novo*[7] and its factual findings with a high level of

[7] *Stegemeier v. Magness*, 728 A.2d 557, 561 (Del. 1999).

deference.[8] We will not set aside a trial court's factual findings "unless they are clearly wrong and the doing of justice requires their overturn."[9]

DV Realty contends "that the Court of Chancery misapplied [a] legal standard when it ruled that the Limited Partners acted in good faith when they determined that DV Realty's late delivery of audited financial statements made removal of DV Realty necessary for the best interest of the Limited Partnership." DV Realty argues that the relevant facts are not in dispute, and that therefore, the Court of Chancery's application of the term "good faith" to the facts is a legal issue. Accordingly, DV Realty argues the decision should be reviewed *de novo*,[10] and points to *Desert Equities, Inc. v. Morgan Stanley Leveraged Equity Fund, II, L.P.*[11] in support of that contention.

The Limited Partners respond that DV Realty has not identified any question of law for review. The Limited Partners contend that the Court of Chancery's conclusion that the Limited Partners acted in good faith is properly characterized as a factual finding, and cite *Versata Enterprises, Inc.*

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[8] *Montgomery Cellular Hldg. Co. v. Dobler*, 880 A.2d 206, 219 (Del. 2005).
[9] *Id.* (citing *Levitt v. Bouvier*, 287 A.2d 671, 673 (Del. 1972)).
[10] *See Bank of N.Y. Mellon Trust Co., N.A., v. Liberty Media Corp.*, 29 A.3d 225, 236 (Del. 2011) ("Once the historical facts are established, the issue becomes whether the trial court properly concluded that a rule of law is or is not violated. Appellate courts review a trial court's legal conclusions *de novo*.").
[11] *Desert Equities, Inc. v. Morgan Stanley Leveraged Equity Fund, II, L.P.*, 624 A.2d 1199 (Del. 1993).

v. Selectica, Inc. for that proposition.[12] The Limited Partners also cite *Corrado Brothers, Inc. v. Twin City Fire Insurance Co*.[13] in support of their contention that determinations about whether parties acted in good faith are factual in nature.

In our view, the cases cited by the Limited Partners and DV Realty all consistently establish that the review of a conclusion of good faith involves a mixed question of law and fact. The ultimate determination that a party acted in good faith is a legal issue. The factual findings that provide the basis for that determination will not be overturned unless they are clearly erroneous. In *Bank of N.Y. Mellon v. Liberty Media Corp.*, this Court explained:

> The legal issue in this case presents a mixed question of law and fact. The applicable standards of appellate review are well established. After a trial, findings of historical fact are subject to the deferential "clearly erroneous" standard of review. That deferential standard applies not only to historical facts that are based upon credibility determinations but also to findings of historical fact that are based on physical or documentary evidence or inferences from other facts. Where there are two permissible views of the evidence, the factfinder's choice between them cannot be clearly erroneous. Once the historical facts are established, the issue becomes whether the trial court properly concluded that a rule of law is or is not violated. Appellate courts review a trial court's legal conclusions *de novo*.[14]

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[12] *Versata Enterprises, Inc. v. Selectica, Inc*., 5 A.3d 586, 589 (Del. 2010).
[13] *Corrado Bros., Inc. v. Twin City Fire Ins. Co*., 562 A.2d 1188 (Del. 1989).
[14] *Bank of N.Y. Mellon Trust Co., N.A. v. Liberty Media Corp.*, 29 A.3d at 236.

Accordingly, the Court of Chancery's factual findings will be reviewed for "clear error" and its legal determination of good faith will be reviewed by this Court *de novo*.

Contractual Good Faith

The LPA's contractual duty encompasses a concept of "good faith" that is different from the good faith concept addressed by the implied covenant of good faith and fair dealing. In *ASB Allegiance Real Estate Fund v. Scion Breckenridge Managing Member, LLC*, the Court of Chancery articulated the important differences between the implied covenant and the fiduciary duty concepts of good faith.[15] In *Gerber v. Enterprise Products Holdings, LLC*, this Court adopted that well-reasoned analysis as a correct statement of our law.[16]

In *Gerber*, this Court examined a good faith claim within the context of a contractual fiduciary duty. In analyzing that claim, we explained that, like a common law fiduciary duty, a contractual duty to act in good faith looks to "the parties as situated at the time of the wrong."[17] That temporal criterion is important to our analysis in this case.

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[15] *ASB Allegiance Real Estate Fund v. Scion Breckenridge Managing Member, LLC*, 50 A.3d 434, 440-42 (Del. Ch. 2012), *aff'd in part, rev'd in part on other grounds*, 68 A.3d 665 (Del. 2013).
[16] *Gerber v. Enter. Prods. Hldgs., LLC*, 67 A.3d 400, 418 (Del. 2013).
[17] *Id*. (quoting *ASB Allegiance Real Estate Fund v. Scion Breckenridge Managing Member, LLC*, 50 A.3d at 440).

Good Faith Undefined

The language of the LPA does not define good faith. For that reason, the Court of Chancery decided to use the UCC definition of "good faith" because it is "at least" as broad at the common law definition. This Court has never held that the UCC definition of good faith applies to limited partnership agreements.

The UCC applies to specific kinds of contracts, but not to limited partnerships. If the parties wanted to use the UCC definition of good faith, they could have so provided in the LPA or incorporated it as a defined term by reference. Because neither alternative was chosen by the parties to the LPA, the Court of Chancery inappropriately applied the UCC definition of good faith to the LPA.

The "good faith" provision in LPA section 3.10(a)(ii) provides the standard by which to measure the Limited Partners' actions. The LPA's contractual duty requires the Limited Partners "in good faith [to] determine that such removal is necessary for the best interest of the [Limited] Partnership." To determine whether the Limited Partners breached the LPA's contractual duty of good faith, we must first analyze what standard the LPA imposes.

In *Norton v. K-Sea Transportation Partners, L.P.*, we recently considered a contractual good faith requirement and noted our "obligation to construe the agreement's 'overall scheme.'"[18] In *Norton*, we analyzed the contractual duty of good faith in the context of the larger provision—or value—it sought to protect.[19] In the LPA before us, the use of the term "good faith" is in the context of ensuring the Limited Partners do not arbitrarily or capriciously remove the General Partner.

Good Faith/Bad Faith

Many centuries ago, Aristotle observed that we "often gain knowledge of (a) a characteristic by the opposite characteristic, and (b) of characteristics by those things in which they are exhibited."[20] It follows, Aristotle then noted, that if one term in a pair of opposites is used in more than one sense, the other term will also be used in more than one sense.[21] Good faith and bad faith are illustrative examples of opposite characteristics—as described by Aristotle—in that each is used in more than one sense and thereby

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[18] *Norton v. K-Sea Trans. P'rs, L.P.*, 67 A.3d 354, 360 (Del. 2013). Unlike the contractual good faith duty in *Norton v. K-Sea Transportation Partners L.P.*, this LPA does not require a "reasonable belie[f]." *Compare id*. at 361 (emphasis omitted) (noting that the limited partnership agreement permitted the general partner to make any decision under the limited partnership agreement's authority "so long as such action is reasonably believed by [the general partner] to be in, or not inconsistent with, the best interests of the [p]artnership").
[19] *Id.* at 362.
[20] Nicomachean Ethics by Aristotle, Book V.
[21] *Id*.

informs our understanding of each other. For example, in *In re Walt Disney Co. Derivative Litig.*,[22] this Court held that a failure to act in good faith may be shown by "at least three different categories of fiduciary behavior [that] are candidates for the 'bad faith' pejorative label."[23]

In our recent opinion in *Brinckerhoff v. Enbridge Energy Company, Inc.*, we defined the characteristic of good faith by its opposite characteristic—bad faith.[24] We applied a traditional common law definition of the business judgment rule to define a limited partnership agreement's good faith requirement. We used the formula describing conduct that falls outside business judgment protection, namely, an action "so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith."[25] That definition of good faith, as set forth in *Brinckerhoff*, is appropriately applied in this case as well.

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[22] *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27 (Del. 2006).
[23] *Id*. at 64.
[24] *Brinckerhoff v. Enbridge Energy Co., Inc.*, 67 A.3d 369, 373 (Del. 2013) (citing *Parnes v. Bally Entertainment Corp.*, 722 A.2d 1243, 1246 (Del. 1999)).
[25] *Id*.

Record Supports Removal

Section 3.10(a)(ii) required the Limited Partners to determine in good faith that the removal of DV Realty was "necessary in the best interest of the Limited Partnership." Applying the definition in *Brinckerhoff*, that determination will be considered to be in good faith unless the Limited Partners went "so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith."[26] The record establishes that, as the Managing Partner, DV Realty had repeatedly breached its obligation under section 11.5(a) of the LPA to deliver to the Limited Partners audited financial statements on time—by April 30 following the close of each year. The audited financial statements for 2008 were delivered 173 days late (on October 20, 2009); the audited financial statements for 2009 were delivered 303 days late (on March 9, 2011); and the audited financial statements for 2010 were 337 days late as of the time trial commenced (April 2, 2012).

Given these undisputed facts, the Court of Chancery correctly found that the Limited Partners "have shown that the Managing Partner's continuous failure to have the Limited Partnership's audited [f]inancial statements completed in the time prescribed by section 11.5 provided them

[26] *Id*.

with a good faith belief that the Managing Partner needed to be removed for the best interest of the Limited Partnership." As the Court of Chancery explained, "when a limited partnership agreement places, on a general partner, the duty of having the limited partnership's audited financials completed by a specific time, and the general partner consistently fails to meet that duty, it is objectively reasonable to believe that [it] is necessary in the best interest of the limited partnership to replace that general partner." The Court of Chancery also found DV Realty's rebuttal—that the timely issuance of audited financial statements would result in the auditor's "going concern" qualification—did not excuse DV Realty's failure, as the Managing Partner, to timely provide audited financial statements as the LPA required.

The proper good faith standard called for by section 3.10(a)(ii) of the LPA is purely subjective. Therefore, the Court of Chancery ruled incorrectly that "good faith" as used in the LPA, includes both subjective good faith—"honesty in fact"—and an element of objectivity—"reasonable commercial standards of fair dealing" as provided in the UCC. Nevertheless, applying the subjective standard of good faith to the evidence in the record, we hold that the Court of Chancery properly concluded that the Limited Partners met the contractual standard for removal of the Managing Partner

"without Cause" set forth in section 3.10(a)(ii) of the LPA. That is, the Limited Partners "in good faith determine[d] that such removal [was] necessary for the best interest of the [Limited] Partnership."

Red Flag Issues

The Court of Chancery held that "the principal basis for the Limited Partners' decision to remove [DV Realty] was [DV Realty's] consistent failure to have the Limited Partnership's annual audited financial statements completed on time." The Court of Chancery also found that the Red Flag Issues raised by the Final Townsend Report provided modest additional support for the removal decision.

DV Realty claims that the Red Flag Issues are not sufficient to support the removal decision, and that the Court of Chancery erred in giving them any weight. However, DV Realty also asserts "although the Court of Chancery held that three of the 'Red Flag Issues' provided only slight support for the Limited Partners' removal decision, it is clear that without the late audit issue, the Red Flag Issues are not enough to support the removal decision. Thus, the principal issue on appeal is whether the Court of Chancery's ruling on the late audit issue was correct." We agree with those assertions. But, since we have concluded that DV Realty's failure to deliver timely audited financial statements independently provided the

Limited Partners with a sufficient good faith basis for removal of DV Realty as the Managing Partner, it is unnecessary to address the Red Flag Issues.

Conclusion

The judgment of the Court of Chancery is affirmed.