COURT OF CHANCERY
OF THE
STATE OF DELAWARE

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Re: *Karl Fillip v. Centerstone Linen Services, LLC,*
Civil Action No. 8712-ML

Dear Counsel:

This matter involves exceptions taken to an interlocutory Final Report of the Master on the Plaintiff's right to advancement of legal fees in litigation between the parties in Georgia. The Master's Report involved two sets of issues: she first determined that the applicable LLC Agreement provided broad advancement rights, then evaluated the various claims in the Georgia action as either triggering advancement, or not.

The Master's Final Report here was—due to the fluid nature of the Georgia litigation for which advancement of fees is sought—preliminary in several ways.[1] Further, Master Legrow was unable to determine what fees were properly advanced in the Georgia litigation, in part because the affidavits submitted by the Plaintiff, Karl Fillip, "did not contain the level of detail necessary for either Centerstone or the Court to evaluate the reasonableness of that calculation."[2] Additionally, Master Legrow noted that, because of the ongoing nature of this litigation, "additional fees likely [had] been incurred since that affidavit was submitted."[3] Accordingly, she "invite[d] the parties to confer and attempt to negotiate a reasonable method for apportioning fees in the Georgia Action between those claims or defenses that are subject to advancement and those that are not," recognizing that "[i]f the parties are unable to agree, additional motion practice will be necessary."[4]

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[1] For instance, the Master's Final Report recognized that, because "Centerstone had not completed contention interrogatories directed toward clarifying the basis for Count III" of its amended counterclaims, Fillip was unable to determine whether this counterclaim was one for which he would be entitled to advancement. *Fillip v. Centerstone Linen Servs. LLC*, 2013 WL 6671663, at *10 (Del. Ch. Dec. 3, 2013), *as corrected* (Dec. 11, 2013). Thus, in her Final Report, Master Legrow requested supplemental briefing on the issue of whether this counterclaim was subject to advancement, if the parties could not agree on this point extra-judicially. *Id.* Fillip has decided not to pursue advancement as it relates to this counterclaim. Pl.'s Answering Br. in Opp'n to the Def.'s Exceptions at 17.

[2] *Fillip*, 2013 WL 6671663, at *13.

[3] *Id.*

[4] *Id.* At Oral Argument on Centerstone's Exceptions, the Company represented that the parties met and conferred shortly after the Master's ruling, but that the Company, at least, was naturally reluctant to come to an agreement pending my ruling on any exceptions.

In addition to the fact that Master Legrow's preliminary findings may change based on the additional submissions requested, there have been developments in the Georgia litigation that likely impact her rulings. Most notably, following Oral Argument on the Plaintiff's Motion for Summary Judgment and the Defendant's Motion to Dismiss before the Master, Centerstone amended its previously-amended counterclaims. Consequently, the counterclaims currently pending against Fillip differ from those that the Master reviewed in her Report. Thus, judicial and litigants' economy is best served by my addressing only the Master's interpretation of the nature of the advancement rights provided by the LLC Agreement. For the following reasons, I find, as did the Master, that the LLC Agreement mandates advancement of expenses, including costs, incurred by any Centerstone Manager or Officer by reason of his position. Having made that determination, I remand the matter to the Master to apply this interpretation to Fillip's specific requests for advancement in the Georgia litigation, as well as to determine the appropriate apportionment of fees, in accordance with this Letter Opinion.

A. *Facts*

Neither party has taken Exceptions to the Master's presentation of facts in this matter. For that reason, and after independent review of the record,[5] I adopt the facts as recited in the Master's Final Report. Here, I limn the facts briefly, including only those necessary to my decision.

Karl Fillip was the co-founder of Alliance Laundry and Textile Services ("Alliance").[6] In 2008, Fillip and his Alliance co-founder sold that company to Centerstone Linen Services, LLC ("Centerstone" or "the Company"), a Delaware limited liability company that provides healthcare linen services.[7] Karl Fillip became a Manager of Centerstone; he currently serves as one of six Managers.[8] Pursuant to a Member Service Agreement (the "Employment Agreement"), from May 15, 2008 until early October 2012, he was also Centerstone's CEO.[9]

In October 2012, Fillip resigned from his position as CEO, for what he purports was "Good Reason" under the terms of his Employment Agreement.[10] Resigning for Good Reason preserves certain rights for Fillip under the

[5] The Master's Report here is exemplary of the judicious and scholarly work done in this Court by its Masters. It is indeed unfortunate that the full value of this work to our litigants and bar at times goes unrealized, due to the de novo standard of review; it is particularly regrettable that such review at an interlocutory stage interrupts summary resolution of time-sensitive matters like advancement.
[6] Compl. ¶¶ 7-8.
[7] *Id.* at ¶¶ 7, 9.
[8] *Id.* at ¶ 12.
[9] *Id.* at ¶¶ 10, 15.
[10] *Id.* at ¶ 15.

Employment Agreement.[11] On December 4, 2012, after making an unsuccessful demand on the Company for amounts allegedly owed to him under that Agreement, Fillip filed an action against Centerstone in the Superior Court of Fulton County, Georgia, alleging that Centerstone had breached the Employment Agreement by, among other things, not paying certain bonus amounts or severance pay.[12] Fillip is also seeking a declaratory judgment in that action regarding the Employment Agreement's restrictive covenants, as well as injunctive relief enjoining the Company from enforcing these restrictive covenants.[13]

After an attempt at negotiation, Centerstone filed its answer and counterclaims in Georgia, asserting several affirmative defenses and counterclaims against Fillip. After Centerstone's answer and counterclaims were filed, Fillip sent a demand letter to the Company "for indemnification of all costs, losses, liabilities, and damages paid or incurred by Fillip in defending against the [counterclaims]."[14] Fillip contends that he is entitled to indemnification—as well as advancement—in accordance with Article 3.7 of the LLC Agreement. On April 19, 2013, the Company refused Fillip's request.[15] However, in its letter to Fillip, the Company stated that it would withdraw certain counterclaims—*without* prejudice—because

[11] *See, e.g., id.*
[12] *Id.* at ¶¶ 16-18; *see also* Compl. Ex A (Georgia Compl.) at ¶¶ 42-45.
[13] Compl. ¶ 18; *see also* Compl. Ex A (Georgia Compl.) at ¶¶ 46-59.
[14] Compl. ¶ 29.
[15] *Id.* at ¶ 30.

it had "decided that it would not be in Centerstone's best interests to pursue those claims that could potentially trigger an obligation by Centerstone to pay Mr. Fillip's attorney's fees and costs in defending them."[16] Nonetheless, there has been no order entered in Georgia dismissing these counterclaims *with* prejudice.[17] The Company has amended its counterclaims twice; the last amendment followed oral argument leading to the Master's Final Report in this matter.

B. *Procedural History*

On July 9, 2013, Fillip filed a Verified Complaint for Advancement. On August 5, Centerstone moved to dismiss, and on August 23, Fillip moved for summary judgment. On December 3, Master Legrow issued her Final Master's Report.[18] On December 10, Centerstone filed its Notice of Exceptions, taking Ten Exceptions to Master Legrow's Final Report. Most relevant here is the Company's Exception to Master Legrow's finding that Article 3.7 of the LLC Act "extends mandatory advancement rights to any manager or officer of Centerstone who incurs costs or expenses by reason of his position as manager or officer of the company."[19] For the reasons that follow, I reach the same conclusion as did the Master.

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[16] *Id.* at ¶ 31 (quoting Compl. Ex. F at 2).
[17] *See, e.g.*, Pl.'s Answering Br. in Opp'n to the Def.'s Exceptions at 16.
[18] A minor correction to this Report was made on December 11.
[19] *Fillip v. Centerstone Linen Servs., LLC*, 2013 WL 6671663, at *8 (Del. Ch. Dec. 3, 2013), *as corrected* (Dec. 11, 2013).

C. *Standard of Review*

In the proceedings below, Centerstone filed a Motion to Dismiss Fillip's Verified Complaint. A motion to dismiss pursuant to Court of Chancery Rule 12(b)(6) is governed by this Court's reasonable conceivability standard, and will be denied "unless the plaintiff could not recover under any reasonably conceivable set of circumstances susceptible of proof."[20] In considering a motion to dismiss, I must "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, [and] draw all reasonable inferences in favor of the plaintiff."[21]

Almost simultaneously, Fillip moved for summary judgment. "Summary judgment is appropriate when there are no questions of material fact and the moving party is entitled to judgment as a matter of law."[22] In considering a motion for summary judgment, "the facts must be viewed in the light most favorable to the nonmoving party and the moving party has the burden of demonstrating that there is no material question of fact."[23]

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[20] *Cent. Mortgage Co. v. Morgan Stanley Mortgage Capital Holdings LLC*, 27 A.3d 531, 536 (Del. 2011).
[21] *Id.*
[22] *Senior Tour Players 207 Mgmt. Co., LLC v. Golftown 207 Holding Co., LLC*, 853 A.2d 124, 126 (Del. Ch. 2004).
[23] *Id.*

As "[t]hese two standards largely converge where, like here, a dispute turns on issues of contract interpretation,"[24] these Motions were briefed simultaneously, and Exceptions were taken to the Master's Final Report resolving these Motions. A Master's Report is reviewed by this Court de novo.[25]

D. *Analysis*

In Delaware, limited liability companies "are creatures of contract, designed to afford the maximum amount of freedom of contract, private ordering and flexibility to the parties involved."[26] Accordingly, "duties or obligations must be found in the LLC Agreement or some other contract."[27] In regards to advancement and indemnification, Section 18-108 of the Delaware Limited Liability Company Act provides:

> Subject to such standards and restrictions, if any, as are set forth in its limited liability company agreement, a limited liability company may, and shall have the power to, indemnify and hold harmless any member or manager or other person from and against any and all claims and demands whatsoever.[28]

[24] *Stockman v. Heartland Indus. Partners, L.P.*, 2009 WL 2096213, at *4 (Del. Ch. July 14, 2009) (explaining that, "[i]n both cases, a moving party is generally only entitled to a claim-dispositive order on its motion—either for summary judgment or dismissal—where the contract is unambiguous").
[25] Ct. Ch. R. 144(a)(2).
[26] *TravelCenters of Am., LLC v. Brog*, 2008 WL 1746987, at *1 (Del. Ch. Apr. 3, 2008) (internal quotation marks omitted).
[27] *Fisk Ventures LLC v. Segal et al.*, 2008 WL 1961156, at *8 (Del. Ch. May 7, 2008).
[28] 6 *Del. C.* § 18-108.

This Court has "made clear that § 108 defers completely to the contracting parties to create and delimit rights and obligations with respect to indemnification and advancement."[29]

In the matter before me, both parties aver that the language of the indemnification provision contained in Centerstone's LLC Agreement is unambiguous. That provision—Article 3.7—reads:

> The Company shall indemnify, defend and hold harmless each Manager and Officer for all costs, losses, liabilities, and damages whatsoever paid or incurred by such Manager or Officer in the performance of his duties in such capacity, including, without limitation, reasonable attorney's fees, expert witness and court costs, to the fullest extent provided or permitted by the Act or other applicable laws. Further, in the event fraud or bad faith claims are asserted against such Manager or Officer, the Company shall nonetheless bear all of the aforesaid expenses subject to the obligation of such Manager or Officer to repay all such expenses if they are finally determined to have committed such fraud or bad faith acts.[30]

Although this provision does not contain the word "advancement" or some variation thereof, both parties agree that this provision provides some form of mandatory advancement. However, the parties dispute the scope of the Company's advancement obligations. Fillip argues that the LLC Agreement clearly and unambiguously mandates advancement "for all costs, losses, liabilities, and damages whatsoever paid or incurred by such Manager or Officer in the

[29] *Majkowski v. Am. Imaging Mgmt. Servs., LLC*, 913 A.2d 572, 591 (Del. Ch. 2006) (internal quotation marks omitted).
[30] LLC Agmt. § 3.7.

performance of his duties in such capacity, including, without limitation, reasonable attorney's fees . . . ." Conversely, under Centerstone's reading, Article 3.7 is bifurcated, such that the first sentence provides for indemnification, and the second sentence provides for advancement; thus, advancement is only mandated "in the event fraud or bad faith claims are asserted against such Manager or Officer."

This Court's tenets of contract interpretation are well-established. If the language of the indemnification provision at issue is unambiguous, "I must give full effect to its meaning."[31] Conversely, if the contractual language at issue is "reasonably or fairly susceptible of different interpretations," I must interpret any ambiguity in favor of the non-moving party.[32] Based on a reading of Article 3.7 in its entirety, I find that this Article unambiguously mandates advancement to Centerstone Managers and Officers of all expenses incurred by reason of their position, and not solely those expenses incurred when "fraud or bad faith claims are asserted against such Manager or Officer."[33]

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[31] *ENI Holdings, LLC v. KBR Grp. Holdings, LLC*, 2013 WL 6186326, at *6 (Del. Ch. Nov. 27, 2013).
[32] *Id.* (internal quotation marks omitted).
[33] *See, e.g.*, *Majkowski*, 913 A.2d at 593 (discussing "the fact that a limited liability company will only be obligated to advance litigation expenses to an officer when its LLC agreement expressly states the company's intention to mandate advancement").

1. Article 3.7 provides advancement for instances other than fraud or bad faith

Article 3.7 consists of two sentences. The first provides, in connection with costs (including attorney's fees) incurred by Managers and Officers in the performance of their duties, that the Company shall "indemnify . . . and hold harmless" such Managers and Officers for all such costs. The ellipse above, however, also contains the word "defend." In other words, the Company also agrees to "defend . . . for all costs . . . incurred." According to the Company, this "defense" obligation is meaningless surplusage; such a construction, however, is contrary to the canon of construction that all language in a contract is to be given meaning so far as possible.[34] The Plaintiff avers that an undertaking to "defend" for all costs incurred should be read synonymously with "advance;" this, too, is problematic, because although both "defend" and "advance" imply a duty to assist in litigation before its ultimate conclusion—rather than simply indemnify—an obligation to defend is not the equivalent of an obligation to advance defense costs, in common usage.[35] If this first sentence represented all of Article 3.7, its meaning would be ambiguous.

[34] *See, e.g.*, *MicroStrategy Inc. v. Acacia Research Corp.*, 2010 WL 5550455, at *6 (Del. Ch. Dec. 30, 2010) (describing the "long-settled principle of contract interpretation that the Court must 'read a contract as a whole and . . . give each provision and term effect, so as not to render any part of the contract mere surplusage'").

[35] *See, e.g.*, *Lorillard Tobacco Co. v. Am. Legacy Found.*, 903 A.2d 728, 740 (Del. 2006) ("As we have stated before, the true test is not what the parties to the contract intended it to mean, but what a reasonable person in the position of the parties would have thought it meant.") (internal

Article 3.7, however, contains a second sentence that clarifies the meaning of the Article, read as a whole.[36] It provides that, "[f]urther, in the event fraud or bad faith claims are asserted against such Manager or Officer, the Company shall nonetheless bear all of the aforesaid expenses subject to the obligation . . . to repay . . . if they are finally determined to have committed such fraud or bad faith acts." The second sentence of the Article clearly assumes that the "aforesaid expenses"—including defense costs—will have been prepaid, that is, advanced, as only advanced expenses can be subject to an undertaking to repay. The second sentence makes clear that, even in cases of fraud or bad faith, the Company is liable for advancement, subject to an undertaking to repay. The ambiguity in the first sentence is thus cured by reading the Article in its entirety.

The Company's alternative reading of the second sentence is that it is a grant of advancement rights, but only for claims of fraudulent or bad faith acts. First, this is inconsistent with my understanding of the language, which provides that, even in case of fraud or bad faith, "the Company shall *nonetheless* bear *all of the aforesaid expenses*" subject to an obligation to repay. It is clear that this language is clarifying duties and rights with a respect to a *subset* of the total costs that might

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quotation marks omitted); *Eagle Indus., Inc. v. DeVilbiss Health Care, Inc.*, 702 A.2d 1228, 1232 (Del. 1997) ("Contract terms themselves will be controlling when they establish the parties' common meaning so that a reasonable person in the position of either party would have no expectations inconsistent with the contract language.").

[36] *See, e.g.*, *Stockman v. Heartland Indus. Partners, L.P.*, 2009 WL 2096213, at *6 (Del. Ch. July 14, 2009) ("A basic principle of contract interpretation is that the [C]ourt reads an agreement as a whole to give effect to each term and to harmonize seemingly conflicting terms.").

be advanced, which are "all costs" referred to in the first sentence; and that this section is not creating a separate advancement right. The Company has agreed to advancement of costs, including—"nonetheless"—in cases of fraud or bad faith. The second problem with the construction suggested by the Company is that it defies common sense. The Company's reading would secure a right to advancement where the Company accuses its Members and Officers of fraud and bad faith, but permit the Company to deny advancement rights where less culpable acts are alleged. It is unlikely this is what the Company meant to convey, nor can it be the right that the Plaintiff thought he had secured in contract. Rather, the Company contracted to provide advancement of expenses incurred by a Manager or Officer in performance of his duties.

Although Centerstone argues that this interpretation renders the second sentence of Article 3.7 surplusage, I disagree. The second sentence acts to clarify an important point within the advancement context—whether fees can be advanced when fraud and bad faith claims are asserted.[37] Additionally, the second sentence addresses certain repayment obligations of Managers and Officers who have been

[37] As described above, if the parties were to distinguish between a right to advancement in cases of fraud versus cases where no fraud is alleged, intuitively the result would be the opposite of Centerstone's contention here—the parties would want to limit or eliminate mandatory advancement rights in cases where fraud *is* alleged. This intuition supports my finding that the second sentence is not surplusage, but instead clarifies an important concern in the advancement context—whether advancement will be provided when fraud or bad faith is alleged.

advanced expenses. Therefore, my interpretation of Article 3.7 does not lead to surplusage.

2. Scope of the advancement right

Article 3.7—read as a whole—provides for advancement of expenses "paid or incurred by such Manager or Officer *in the performance of his duties in such capacity.*" The parties originally disputed the meaning of this phrase, with Centerstone arguing that this "performance of his duties" standard was "far more stringent" than the "by reason of the fact that the person is or was a director, officer, employee or agent of the corporation . . ." standard referenced in 8 *Del. C.* § 145, a standard with a well-defined meaning in case law.[38] However, the Company's interpretation is not supported by a close textual analysis of the language. Rather, Centerstone merely proposes that because the language used is *different*, the Company must have intended to *narrow* its advancement obligations.[39] Despite taking this position during briefing, at Oral Argument on its Exceptions Centerstone's counsel conceded that the Company was not disputing the Master's finding that these terms are interchangeable, but instead arguing that her determination of the scope of advancement under either standard—"in the performance of his duties" or "by reason of the fact" of his position—was

[38] Def.'s Answering Br. in Opp'n to Pl.'s Mot. for Summ. J. at 15.

[39] *See, e.g.*, Oral Arg. Tr. (Oct. 1, 2013) 54:10-16 ("Well, first, I just look at the words themselves. On the corporate side, it's typically far more broad. It's not limited to, you know, in the performance of one's duties. So I think the words themselves automatically narrow . . . what we're talking about here.").

incorrect. Because the Company has not offered a convincing explanation of why the phrase "in the performance of his duties" is meant to signify something narrower than "by reason of the fact" of his position, I find that the meaning of the latter phrase, as explicated in our case law, controls here.

For the reasons addressed above, it would be premature to address further the Master's findings as to application of the Plaintiff's right to advancement. The arguments made by the Company in its Exceptions in regard to those findings are preserved pending a final determination by the Master.

E. *Conclusion*

It is far from uncommon that an entity finds it useful to offer broad advancement rights when encouraging an employee to enter a contract, and then finds it financially unpalatable, even morally repugnant, to perform that contract once it alleges wrongdoing against the employee. For the foregoing reasons, I find that Article 3.7 of the LLC Agreement mandates advancement of expenses, including costs, incurred by any Centerstone Manager or Officer by reason of his position as officer or manager. I remand the remaining factual issues to Master Legrow, for her determination in accordance with my legal analysis. I also recommend that the Master direct a meet and confer with the parties, as the Company has conceded that Fillip is entitled to some advancement rights with

respect to costs already incurred resulting from its original counterclaims.[40] Given the lengthy period for which this case has been pending, I encourage the Master to work with the parties to determine an agreed-upon amount of advancement for those counterclaims to which the Company has conceded that advancement is owed, while Fillip awaits a final judgment. IT IS SO ORDERED.

Sincerely,

/s/ Sam Glasscock III
Sam Glasscock III

[40] *See, e.g.*, Oral Arg. Tr. (Oct. 1, 2013) 68:16-71:5.