



IN THE SUPREME COURT OF THE STATE OF DELAWARE

DV REALTY ADVISORS LLC, §  
§  
Defendant Below, §  
Appellant, §  
§  
v. §  
§  
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. §

No. 547, 2012

On Appeal from the  
Court of Chancery  
of the State of Delaware,  
C.A. No. 7204

**REPLY BRIEF OF APPELLANT**  
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## PRELIMINARY STATEMENT

In their twenty-two page Answering Brief, the Limited Partners<sup>1</sup> spend little time responding to the substantive merits of the arguments that DV Realty made in its Opening Brief, instead focusing much of their brief on technicalities. For example, the Limited Partners' lead-out argument is that DV Realty is barred from challenging the Court of Chancery's conclusion that they acted in good faith because DV Realty purportedly mislabeled that conclusion as one of law rather than fact. As explained below, that argument fails because: (1) the Court of Chancery's good faith conclusion is legal, not factual; and (2) in any event, however the good faith conclusion is labeled, DV Realty challenged it in its Opening Brief.

Once the Limited Partners' brief did get to the merits of the appeal, they largely repeat the Court of Chancery's Memorandum Opinion. Significantly, despite their technical complaints, the Limited Partners did not challenge the accuracy of any of the undisputed facts upon which DV Realty premises this appeal. The Limited Partners also failed to explain why, given those undisputed facts, it was necessary to remove DV Realty for the best interests of the Limited Partnership, as is required by the LPA to sustain their attempted removal of DV Realty as managing general partner. As explained in DV Realty's Opening Brief and herein, the Court of Chancery's Judgment should be reversed because the undisputed facts do not support its conclusion that the Limited Partners determined in

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<sup>1</sup> Capitalized terms are defined in the Corrected Opening Brief of Appellant DV Realty Advisors, LP ("Opening Brief" or "Op. Br.").

good faith that removing DV Realty was necessary for the best interests of the Limited Partnership.

## ARGUMENT

### I. THE COURT OF CHANCERY COMMITTED REVERSIBLE ERROR WHEN IT HELD THAT THE AUDIT DELAYS PROVIDED THE LIMITED PARTNERS WITH A GOOD FAITH BASIS FOR REMOVAL.<sup>2</sup>

#### A. The Standard of Review is *De Novo*.

The Limited Partners first argue that the Court of Chancery's good faith determination should be reviewed under the clearly erroneous standard because it was a factual finding. (Ans. Br. at 11.) In support of that argument the Limited Partners cite several cases for the general proposition that the existence of good faith is typically a factual issue. (*Id.* at 12-13.) However, none of those cases state that a good faith finding is always and exclusively a finding of fact.

To the contrary, Delaware courts have held that good faith is not solely a matter of fact. In *Desert Equities, Inc. v. Morgan Stanley Leveraged Equity Fund, II, L.P.*, 624 A.2d 1199 (Del. 1993), this Court held that the reasonableness of a general partner's conduct was a "mixed question of fact and law." *Id.* at 1206. Also, in *Hernandez v. Boston Market, Inc.*, 2005 WL 181655, at \*1 (Del. Super. Jan. 26, 2005), the court found that a mixed question of fact and law existed where the parties "largely agree[d] about what happened," but "clash[ed] over the facts' legal significance," so the "dispute primarily concern[ed] a question of law."

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<sup>2</sup> In a footnote, the Limited Partners noted that DV Realty inadvertently omitted citations to the record pages where this question was presented below, but do not contend that the question was not preserved. (See Ans. Br. at 11 n.3.) The question was presented below at AR7-11, AR13-17.

Like those cases, this appeal involves a mixed question of fact and law because the parties agree on the underlying facts; they disagree about the application of those facts to the standard of good faith that is applicable here. Indeed, DV Realty's Opening Brief lists eight facts, all based on the Limited Partners' admissions at trial, which demonstrate the absence of good faith and require reversal of the Court of Chancery's Judgment. (Op. Br. at 27-28). Significantly, the Limited Partners do not dispute any of those facts. Thus, the issue raised in this appeal is not the trial court's weighing of the evidence, evaluating witnesses' credibility or determining what happened. Rather, the issue raised on this appeal is whether the Court of Chancery erred when it held that the facts that it found add up to the conclusion that the Limited Partners' conduct satisfied the good faith standard supplied by the LPA.

Because the issue on appeal is whether the court properly applied the undisputed facts to the law, it is a legal question that is subject to *de novo* review. *Scharf v. Edgcomb Corp.*, 864 A.2d 909, 916 (Del. 2004) ("Once the historical facts are established . . . the ultimate determination of the legal issue presented is reviewed by appellate courts *de novo*."); *Bank of N.Y. Mellon Trust Co. 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*.").

**B. Even if the Court of Chancery's Conclusion Is Properly Labeled A Finding of Fact, DV Realty Has Not Waived Its Challenge to that Finding.**

The Limited Partners argue that DV Realty is barred from challenging the Court of Chancery's conclusion that the Limited Partners acted in good faith because: (a) that was a factual conclusion, and (b) DV Realty did not challenge any of the Court of Chancery's factual findings. (Ans. Br. at 14.) The Limited Partners' argument should be rejected for at least two reasons. First, as explained above, in the context of this case -- where the facts underlying the trial court's ruling are not in dispute -- the Court of Chancery's good faith determination presents a question of law, not a question of fact.

Second, even if the Court of Chancery's determination that the Limited Partners acted in good faith is a factual finding, the Limited Partners' argument is nothing more than semantics. DV Realty's Opening Brief challenged the Court of Chancery's determination that the Limited Partners acted in good faith, regardless whether it is legal or factual in nature. That is, DV Realty's arguments on appeal as to why the good faith ruling should be reversed remain the same regardless of how the conclusion is labeled. The only significance to the "legal versus factual" debate is what standard of review applies.

The two cases cited by the Limited Partners in support of their waiver argument, *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*, \_\_ A.3d \_\_, 2012 WL 2783101 (Del. July 12, 2012), and *Murphy v. State*, 632 A.2d 1150 (Del. 1993), are distinguishable. Both referred to the appellant's failure to challenge a disputed factual finding on



appeal. DV Realty has not failed to challenge the good faith determination and the Limited Partners do not contend otherwise; their only dispute appears to be with how the challenge is phrased. And in any event, the cases on which the Limited Partners rely do not say that an appellant's purported failure to label the issue on appeal as factual versus legal results in a waiver. Such a rule would be contrary to the Court's policy of deciding appeals on the merits. *State Personnel Commission v. Howard*, 420 A.2d 135, 137 (Del. 1980) ("the modern trend developed in recent years in both state and federal courts, de-emphasizes the technical procedural aspects of appeals and stresses the importance of reaching and deciding the substantive merits of appeals whenever possible."). Accordingly, the Limited Partners' waiver argument should be rejected.

**C. The Court of Chancery Correctly Held That The Good Faith Standard Under The LPA Contains A Good Faith Component.**

The Limited Partners next argue that the Court of Chancery erred when it applied an objective component to the definition of good faith. (Ans. Br. at 15-16.) The Limited Partners argue in conclusory fashion that "the Court of Chancery held the Limited Partners to a higher standard than the purely subjective one that the LPA expressly calls for." (*Id.* at 16.) This argument should be rejected because, as the Court of Chancery held, the LPA does not "expressly" (or inferentially) call for a purely subjective standard of good faith.

To the contrary, Section 3.10(a)(ii) of the LPA states that the Limited Partners can only remove DV Realty if they first determine in good faith that the removal is necessary for the best interests of the Limited Partnership. Under the Limited Partners' subjective-only

definition, the protections from arbitrary and unreasonable removal that Section 3.10(a)(ii) was intended to provide to DV Realty would be eviscerated. The Limited Partners would have free reign to remove DV Realty for any reason so long as they alone believed it proper, no matter how unreasonable. This result would be contrary to both the parties' intention, as expressed by the plain language of Section 3.10(a)(ii) in the LPA, and Delaware law. See *Wilmington Leasing, Inc. v. Parrish Leasing Co., L.P.*, 1996 WL 560190, at \*2 (Del. Ch. Sept. 25, 1996) (finding that a removal provision in a limited partnership agreement implied a requirement that the limited partners exercise removal discretion granted to them reasonably and in good faith so as not to "marginalize[]" the protections of the removal provision). Thus, the Court of Chancery correctly held that the good faith requirement of Section 3.10(a)(ii) of the LPA contains an objective component. (See Op. at 35.)

Based upon their erroneous claim that the Court of Chancery's conclusion that there is an objective component to the good faith requirement of the LPA is incorrect, the Limited Partners argue that the Judgment should be affirmed despite the absence of objective good faith on their part because DV Realty "concedes that the Limited Partners met the subjective component of the [good faith] standard." (Ans. Br. at 16.) That is not correct, either; DV Realty did not concede subjective good faith and, rather, has argued just the opposite. As discussed in the Opening Brief, the Limited Partners could not have had -- and did not have -- a subjective, good faith belief that removing DV Realty was necessary for the best interest of

the Limited Partnership. (See, e.g., Op. Br. at 28 ("Given these undisputed facts, the Limited Partners could not have reasonably concluded (and did not reasonably conclude) that receiving a timely audit with a 'going concern' note was better for the Limited Partnership than receiving an untimely audit without a 'going concern' note -- let alone that it was necessary. Indeed, the Limited Partners' own complaint reveals that they wanted the audits sooner . . . so that they could meet their own internal reporting requirements . . ." (emphasis in original)); *id.* at 29 ("Furthermore, if removing DV Realty was really 'necessary', then what took the Limited Partners so long to do it? Most of the issues that the Limited Partners complain about -- including the audit issue -- first took place before 2010, yet the Limited Partners did not vote to remove DV Realty until June 2011"); *id.* at 33 ("If anything, the Limited Partners' reliance on Vanecko's resignation for their removal decision shows that they are not acting in good faith.")).

The undisputed facts in this case (which are described in detail in DV Realty's Opening Brief) establish that the Limited Partners did not have either a subjective or objective basis for believing that removing DV Realty was necessary for the best interests of the Limited Partnership. Therefore, the Court of Chancery's removal decision should be reversed.

**D. The Undisputed Facts Demonstrate That The Court of Chancery's Good Faith Finding Was Incorrect And Should Be Reversed.**

In its Opening Brief, DV Realty argued that the audit issue could not be viewed in the abstract. (Op. Br. at 26-28.) Rather, as the

Court of Chancery held, context matters and should be considered in determining whether the Limited Partners acted in good faith. DV Realty argued that given the undisputed facts regarding the reason for the audit delay, the Limited Partners could not have determined in good faith that removing DV Realty was necessary for the best interests of the Limited Partnership. In response, the Limited Partners argue that they "do not have to prove that any specific business decision made removal necessary." (Ans. Br. at 17.) Rather, according to the Limited Partners, they "merely have to prove that in their good faith belief, a change in leadership of the Limited Partnership was necessary for the entity's best interest." (*Id.*). This circular argument is another spin on the Limited Partners' theme -- rejected by the Court of Chancery and not appealed -- that only their subjective intention is relevant. As discussed above, it is incorrect.

Furthermore, this argument is a red herring. The issue here is not whether the Limited Partners could have prevailed on some other set of facts that were not presented to the Court of Chancery. Whether or not the Limited Partners had to prove that a specific business decision necessitated DV Realty's removal, that is the case they chose to present: the Limited Partners argued that the proof of their good faith belief that removal was necessary was the delay in receiving the audited financials. (See B7.) Likewise, the Court of Chancery's ruling that the removal was effective was based on the audit issue. Thus, in determining whether the Court of Chancery's ruling was correct, the relevant inquiry must be whether the audit

issue could really have led the Limited Partners to believe in good faith that removing DV Realty was necessary for the best interests of the Limited Partnership. As explained in DV Realty's Opening Brief, the undisputed facts prove that, in the context of this case, the Limited Partners could not have made that determination in good faith. (Op. Br. at 26-29). Therefore, the Court of Chancery should be reversed.

The Limited Partners also argue that their removal decision was made in good faith because they disagreed with DV Realty's business judgment that avoidance of a going concern opinion in the audit was more important than having the audit issued in the time prescribed by Section 11.5 of the LPA. (Ans. Br. at 19.) As described in the Opening Brief, DV Realty was hooked on the horns of dilemma caused by factors outside of its control, such as the collapse of the real estate market in 2008. It was left with the options of causing the audit to be issued within the LPA's 120-day deadline with a "going concern" note, with negative consequences for the Limited Partnership, or missing the deadline and resolving the going concern issue. (Op. Br. at 26-29). The Limited Partners argue that in so doing DV Realty breached the LPA.<sup>3</sup> They, however, point to no evidence that disagreement with how DV Realty chose to exercise its business judgment equates to proving that it was necessary for the Limited Partnership's best interest to remove DV Realty.

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<sup>3</sup> The Limited Partners did not contend that the breach of the LPA was so material that it amounted to "cause" to remove DV Realty.

More importantly, the record does not support the existence of any such purported disagreement in the first place. In fact, the Limited Partners admitted at trial that: (a) they understood that receiving a "going concern" note in the audit would be bad for the Limited Partnership, and (b) they never asked DV Realty to cause the audit to be issued with a "going concern" note. (See Op. Br. at 10-11.) The Limited Partners argue that evidence of their disagreement on the audit issue can be found at footnote 113 in the Court of Chancery's Memorandum Opinion. (Ans. Br. at 19). But the testimony and evidence cited at footnote 113 shows that the Limited Partners were anxious to receive the audits and were frustrated by the delays. DV Realty shared in that frustration and kept the Limited Partners informed of the progress that was being made on getting a "clean" audit issued. (See Op. Br. at 9-13, 17-20.) It does not show that they actually disagreed with DV Realty's business judgment on the audit issue. In fact, Huber (executive director of the Teachers Fund) admitted that as a limited partner he had no right to interfere with DV Realty's business judgment on this matter. (A47 at 130:21-131:7 (Huber).)

Notably, in contrast to the Limited Partners' claims that the audit was of such importance that delay in receiving it made it necessary to remove DV Realty, Huber -- the executive director of the Limited Partner with the largest stake in the Limited Partnership<sup>4</sup> --

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<sup>4</sup> The Teacher's Fund committed to contribute \$25 million to the total \$71 million that was committed to be contributed to the Limited Partnership. (A20 at 22 (Huber).) Accordingly, the Teacher's Fund owns approximately 35% of the limited partnership interests in the

admitted at trial that he never even bothered to read the audit. (A47 at 131:18-132:1 (Huber).) The timely issuance of the audit cannot be so important that its late delivery necessitated removal of DV Realty for the Limited Partnership's best interest, when on the other hand, the audit did not even merit an executive director's reading it.

Finally, in the fact section of their Answering Brief, the Limited Partners argue that "the Managing Partner offered no lender testimony or lender document to back its 'going concern' excuse, nor did the Managing Partner offer any testimony explaining why, year after year, it did not proactively manage the underlying conditions giving rise to the supposed 'going concern' justification." (Ans. Br. at 8.) Although the Limited Partners never developed this argument as a basis for affirming the Court of Chancery's Judgment, DV Realty is constrained to respond. DV Realty was under no obligation to introduce third party testimony to support a point that was not in dispute. The Limited Partners admitted that they do not doubt the truth of DV Realty's explanation for the audit delay. (See Op. Br. at 11). The Limited Partners also admitted that, after 2007, it became more difficult for DV Realty (and everyone else) to obtain loan extensions because of the unprecedented problems in the real estate market and that they had no reason to believe that DV Realty was not doing everything possible to alleviate the "going concern" issue. (See *id.*) DV Realty repeatedly explained to the Limited Partners that

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Limited Partnership. Because Section 3.10(a)(ii) requires a 75% vote by the Limited Partners to remove DV Realty, the Teacher's Fund's approval of the removal is required for it to be effective. Thus, if Teacher's Fund did not act in good faith, the Court of Chancery's removal decision must be reversed, regardless whether the other Limited Partners acted in good faith.

it was working with lenders to get the loans extended, but that "it has been difficult to get the banks we are dealing with to focus on renewing loans substantially before their actual maturities." (See *id.* at 18.) Moreover, DV Realty introduced the RSM Memorandum at trial, which confirmed DV Realty's explanation of the "going concern" issue and even stated that RSM had encountered similar audit delays for its other 2009 calendar year clients who were trying to get a clean audit opinion. (See *id.* at 19; A465-66.)



**II. THE "RED FLAG" ISSUES DO NOT PROVIDE ADDITIONAL SUPPORT FOR THE COURT OF CHANCERY'S GOOD FAITH DETERMINATION.**

The Limited Partners argue that DV Realty has attempted to "divide and conquer" the red flag issues, which "wrongly discounts the totality of the circumstances besetting the Limited Partners and guiding their evaluation of [DV Realty's] conduct . . . ." (Ans. Br. at 21.) This purely formalistic argument ignores that the only sensible way to discuss those issues and show that they did not provide any basis for the Limited Partners' removal decision was to address them *seriatim*, as DV Realty did in its post-trial brief below<sup>5</sup> and as the Court of Chancery did in the Memorandum Opinion. (See Op. at 47-51.) As explained in DV Realty's Opening Brief, none of the red flag issues should have been afforded any weight in support of the Limited Partners' removal decision. (Op. Br. at 31-34.) Because none of the red flag issues deserve any weight, they are no stronger collectively than they would be individually. In other words, a meritless basis for removal does not gain some degree of merit just because it is joined together with other equally meritless bases for removal. The red flag issues do not provide any basis for removing DV Realty without cause under Section 3.10(a)(ii) of the LPA.<sup>6</sup>

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<sup>5</sup> While the Limited Partners argue that the citation to the Court of Chancery's discussion of the "red flag" issues in the Memorandum Opinion was inadequate, they do not argue that the issue was not preserved by DV Realty. (See Ans. Br. at 20.) To be sure, DV argued below that "the Limited Partners' so-called 'red flags' do not provide a reasonable basis for the Limited Partners' belief that removing [DV Realty] is necessary for the best interests of the [Limited Partnership]." (AR18-26 (capitalization omitted)).

<sup>6</sup> In a footnote, the Limited Partners argue that subsequent events that were unknown to the Limited Partners at the time of the purported removal "confirm" their decision. (Ans. Br. at 21

**CONCLUSION**

For all of the foregoing reasons and those set forth in the Opening Brief, DV Realty respectfully requests that this Court reverse the Court of Chancery's determination that the Limited Partners validly removed DV Realty without cause and remand for entry of an order reinstating DV Realty as the managing general partner of the Limited Partnership.

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n.22). The Court of Chancery correctly declined to give subsequent events any weight in deciding whether the Limited Partners were acting in good faith at the time they purported to remove DV Realty. (Op. at 51 n.132.)