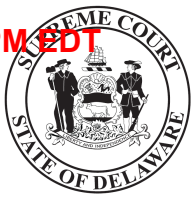

IN THE SUPREME COURT OF THE STATE OF DELAWARE

LINDA MERRITT (a/k/a Lyn Merritt), et al.	:	
Defendants below/Appellants	:	
	:	No. 144-2011
v.	:	
	:	
R&R CAPITAL, LLC and FTP CAPITAL, LLC,	:	
Plaintiffs below/Appellees,	:	
	:	
and	:	
	:	
BUCK & DOE RUN VALLEY FARMS, LLC, et al.,	:	
Nominal Defendants below/ Appellees	:	

OPENING SUPPLEMENTAL BRIEF OF APPELLANTS LINDA MERRITT, MER-LYN FARMS, LLC AND MERRITT LITIGATION SUPPORT, INC.

Filing Date: April 12, 2013

Erik C. Grandell, Esquire
Delaware Supreme Court #2708
1473 Spruce Avenue
Wilmington, DE 19805
(302) 757-6627

Thomas D. Schneider, Esquire
122 South Providence Road
Wallingford, PA 19086
(610) 565-1134
Admitted *pro hac vice*

TABLE OF CONTENTS

TABLE OF CITATIONS

Factual History. In 2003, Lyn Merritt and R&R Capital LLC and FTP Capital LLC (collectively "R&R") formed ten Delaware limited liability companies ("Entities") as vehicles for investments in real estate and racehorses. The Entities' Operating Agreements named Merritt as Managing Member of each entity. Section 9.1 of each agreement requires the Entities to indemnify Merritt and advance legal fees to her in the event of any claims against her:

> Each Member. . .of the Company. . .(an 'Indemnified Party') shall, in accordance with this Article IX, be indemnified and held harmless by the Company from and against any and all losses, claims, damages, liabilities, expenses (including legal and other professional fees and disbursements), judgments, finds, settlements, and other amounts (collectively, the 'Indemnification Obligations') arising from any and all claims, demands, actions, suits or proceedings (civil, criminal, administrative, or investigative), actual or threatened, in which such Indemnified Party may be involved, as a party or otherwise, by reason of such Indemnified Party's service to, or on behalf of, or management of the affairs of, the Company, or rendering of advice or consultation with respect thereto, or which relate to the Company, its properties, business or affairs, whether or not the Indemnified Party continues to be a Member or officer at the time any such Indemnification Obligation is paid or incurred, provided that such Indemnification Obligation resulted from a mistake of judgment, or from action or inaction of such Indemnified Party that did not constitute gross negligence, willful misconduct or bad faith...*Expenses (including legal and other professional fees*

> *and disbursements) incurred in any proceeding will be paid by the Company, as incurred in advance of the final disposition of such proceeding* upon receipt of an undertaking by or on behalf of such Indemnified Party to repay such amount if is shall ultimately be determined that such Indemnified Party is not entitled to be indemnified by the Company as authorized hereunder.[1]

R&R sued Merritt in New York, Pennsylvania, and Delaware in attempts to remove her as Managing Member of the Entities. In 2008, the New York trial court ruled that Merritt was entitled to indemnification as Managing Member of the Entities. Later in 2008, dissatisfied with the New York court's decision, R&R filed two lawsuits against Merritt in Delaware Chancery Court, the second of which sought her removal as Managing Member and liquidation of the Entities. In each case, R&R requested "status quo orders" denying advancement of legal expenses to Merritt. In late August 2008, the Chancery Court, per Chancellor Chandler, granted the status quo order in the second case despite § 9.1's language requiring immediate advancement. Merritt immediately requested advancement, but on September 8, 2008, Chancellor Chandler denied Merritt's request without

[1] Appx. 17-18.

explanation[2]. On February 25, 2009 and July 10, 2009, Chancellor Chandler deferred Merritt's motions for advancement.[3] On September 3, 2009, he granted summary judgment to R&R and removed Merritt as Managing Member.[4] On April 13, 2010, he again denied advancement.[5] Shortly thereafter, he divested Merritt of any interest in the Entities.[6]

Merritt filed a timely appeal. This Court remanded the case to the Chancery Court to resolve whether Chancellor Chandler's decision "to defer ruling on the advancement of attorney's fees [was] supportable. . ." This Court cautioned that "the trial court *should not consider* whether Merritt suffered any prejudice, either because the decision removing Merritt for cause was correct, or because the assistance of counsel could not have changed the result." On March 15, 2013, the Chancery Court, per Chancellor Glasscock, concluded that the decision to defer ruling on the advancement of attorney fees was supportable.

---

[2] Trans. ID 21278987.
[3] Trans ID 24155154, p. 24 (2/25/09); Trans ID 26354286 (7/10/09).
[4] Trans ID 26925800.
[5] Trans ID 30556840.
[6] Trans ID 31868140.

Summary of argument. Chancellor Glasscock erred by treating Merritt's requests as motions to alter the status quo[7] instead of applying the extensive body of advancement law that has developed over several decades. Further, Chancellor Glasscock erred by applying an abuse of discretion standard to the advancement question[8]. The question of advancement is an issue of law subject to *de novo* review. As a matter of law, the Operating Agreements require immediate advancement of fees to Merritt. Deferral of advancement to Merritt was legal error.

In addition, Chancellor Glasscock erred by limiting its focus to only one of multiple orders deferring advancement, Chancellor Chandler's ruling on July 10, 2009[9]. When this Court asked in the remand order whether Chancellor Chandler's decision to defer advancement was supportable, this Court wanted to know whether *all* of the orders were supportable, not just one. The simple answer is that none of the orders are supportable.

---

[7] *R&R Capital, LLC v. Merritt* ("*Merritt*"), slip. op., pp. 21-23 (Del. Ch., 3/15/13).
[8] *Id.*, pp. 22-23.
[9] *Id.*, p. 21.

Moreover, despite this Court's instruction not to consider whether "removing Merritt for cause was correct," Chancellor Glasscock suggested it was proper to defer advancement because Merritt was looting money from the Entities, and Chancellor Chandler knew he was going to remove her as Managing Member[10]. Chancellor Glasscock thus trespassed into territory that this Court declared off limits. And to compound matters, his suggestions of looting are wholly unsupported by the record.

I. As a matter of law, the Operating Agreements require advancement of attorney fees to Merritt.

Requests for advancement raise a strictly legal issue: does the language of the operating agreement require advancement? Decisions on advancement are reviewed *de novo* for errors of law.[11] As a matter of law, the Operating Agreements require summary advancement of legal fees to Merritt. Chancellor Glasscock

---

[10] *Id.*, pp. 25-27.

[11] *Homestore, Inc. v. Tafeen*, 888 A.2d 204, 213 (Del. Supr. 2005) ("The scope of an advancement proceeding is usually summary in nature and limited to determining the issue of entitlement in accordance with the corporation's own uniquely crafted advancement provisions"); *cf. Kaung v. Cole Nat. Corp.*, 884 A.2d 500, 508 (Del. Supr. 2005) (decision on officer's entitlement to advancement is "legal issue presented under *de novo* standard of review").

appears to recognize this point in its March 15, 2013 opinion, stating: "A bare reading of the LLC Agreements suggests that Merritt might have been entitled to advanced fees at the beginning of the Removal Action."[12]

Delaware jurisprudence confirms that the Operating Agreements require advancement. Time and again, courts have enforced advancement provisions virtually identical to § 9.1 of the Operating Agreements.[13] Time and again, courts have held that advancement does not depend on the merits of the member's or officer's underlying case.[14] Time and again, courts have required advancement to corporate officials despite accusations of

---

[12] *Merritt*, p. 28.

[13] *See Tafeen*, *supra*, 888 A.2d at 212 (quoting advancement provision); *Weinstock v. Lazard Debt Recovery GP, LLC*, 2003 WL 21843254, *4 (Del.Ch. 2003) (construing language virtually identical to § 9.1 of the present operating agreements).

[14] *See, e.g.*, *Kaung*, *supra*, 884 A.2d at 509 (scope of an advancement proceeding by corporate official for legal expenses is limited to determining issue of entitlement according to corporation's advancement provisions and not to issues regarding official's alleged conduct in underlying litigation); ***Error! Main Document Only.****Morgan v. Grace*, 2003 WL 22461916, *2, *8 and n.13 (Del. Ch. 2003) (it would be "fallacious" to deny **Error! Main Document Only.**officers advancement on the ground that they would not be indemnified if the conduct alleged were eventually proved true", because this would "blur[] the distinct purpose of advancement provisions").

misconduct against similar to or worse than the accusations R&R has leveled against Merritt.[15] Time and again, courts have stressed the need for advancement early in the case so that the member can defend herself.[16] Merritt is entitled to advancement under these authorities.

R&R argued below that it extinguished Merritt's right to advancement as a *member* under § 9.1 of the Operating Agreements by purporting to remove her as *manager* of the Entities under § 4.5 of the Operating Agreements. Chancellor Glasscock did not base his opinion on this argument – and for good reason. Merritt is entitled to advancement under § 9.1 due to her status as a *member* of the Entities. Section 4.5 only concerns

---

[15] *Tafeen*, *supra*, 888 A.2d at 213-14 (*citing Perconti v. Thornton Oil Corp.*, 2002 WL 982419, *3-*5 (Del.Ch. 2003); *Reddy v. Elec. Data Sys. Corp.,* 2002 WL 1358761, *5-*7 (Del. Ch.), *aff'd* 820 A.2d 371 (Del. 2003) (mem.)) ("*Perconti* is not an isolated decision, but instead reflects a consistent line of authority upholding the contractual…advancement…of corporate officials charged with serious misconduct allegedly inspired by personal greed"); *Bergonzi v. Rite Aid Corp.,* 2003 WL 22407303, *3-4 (Del. Ch. 2003) (Chandler, J.) (CFO entitled to advancement of legal expenses despite entering guilty plea in federal prosecution, since agreement with company guaranteed advancement until final disposition of criminal proceedings).

[16] *Tafeen, supra*, 888 A.2d at 214.

Merritt's rights as a *manager*, a different set of rights than her rights as a *member*. Merritt's advancement rights as a member under § 9.1 continue to this day.

II. Chancellor Glasscock erred by failing to review all of Chancellor Chandler's orders deferring advancement, applying the wrong standard of review, and determining that Chancellor Chandler acted within his discretion.

To justify Chancellor Chandler's decision to defer advancement, Chancellor Glasscock (1) limited his focus to just one of multiple orders deferring advancement, a ruling during a conference on July 10, 2009; (2) labeled Merritt's request during this conference as a motion "to modify the status quo" instead of a motion for advancement; and (3) concluded that Chancellor Chandler acted within his discretion by declining to "modify the status quo" pending a decision on the merits.

This reasoning is defective for multiple reasons. **First**, Chancellor Glasscock failed to examine all of the orders deferring advancement. He restricted his review to the July 10, 2009 ruling on the ground that this was the only ruling recited in the remand order. But since Chancellor Chandler deferred advancement

multiple times,[17] the obvious purpose of this Court's remand order was to ascertain whether *each deferral order* was "supportable". Chancellor Glasscock's failure to review each deferral order substantially affected his decision. He appears to concede that Merritt was entitled to advancement at the commencement of R&R's action.[18] Thus, had he reviewed Chancellor Chandler's September 8, 2008 deferral order[19] (entered just 18 days after R&R commenced this action), he would have had no choice but to recommend advancement in his March 15, 2013 opinion.

Second, Chancellor Glasscock found that after Chancellor Chandler granted R&R a status quo order, (1) the injunction-like standards governing motions to modify status quo orders[20] applied to Merritt's requests for advancement instead of advancement concepts that have evolved over several decades[21]; and (2) denials of motions to modify status quo orders are only reviewed for abuse

---

[17] *See* footnotes 2-3, *supra*, and accompanying text.
[18] *Merritt*, p. 28 ("A bare reading of the LLC Agreements suggests that Merritt might have been entitled to advanced fees at the beginning of the Removal Action").
[19] Trans. ID 21278987 (9/8/08).
[20] *Merritt*, pp. 21-22 n. 74 (standards governing status quo motions are similar to those governing preliminary injunctions).
[21] *See*, *e.g.*, footnotes 11-16, *supra* (collecting advancement cases).

of discretion[22] instead of the *de novo* test applicable to denials of advancement.[23] No reason exists for treating Merritt's requests in this fashion. Her requests for advancement raised a question of law that Chancellor Chandler should have resolved in a summary proceeding. Regardless of whether R&R obtained a status quo order, the Operating Agreements guarantee advancement *as a matter of law*. Chancellor Glasscock erred by concluding that R&R's acquisition of a status quo order changed the advancement issue from a legal question to a discretionary question. Acceptance of the chancellor's reasoning will encourage entities such as R&R to dodge years of advancement law through the procedural device of seeking status quo relief.

Third, even if abuse of discretion is the correct standard, Chancellor Chandler repeatedly abused his discretion. "Judicial discretion is the exercise of judgment directed by conscience and reason, and when a court has not exceeded the bounds of reason in view of the circumstances and *has not so ignored recognized rules of law or practice so as to produce injustice*, its legal discretion has

---

[22] *Merritt*, p. 22.
[23] *See* footnote 11, *supra*, and accompanying text.

not been abused."[24] Chancellor Chandler abused his discretion by deferring advancement in multiple orders, notwithstanding the clear language of the Operating Agreements and "recognized rules of law or practice"[25] that compelled advancement.

The first order on September 8, 2008[26] gave no explanation at all for denying advancement. This absence of reasoning was an abuse of discretion: even Chancellor Glasscock appears to concede that Merritt was entitled to advancement at this point in the litigation[27].

In his second order on February 25, 2009, Chancellor Chandler purported to "stay" proceedings in Delaware pending the outcome of R&R's appeal of an injunction in New York. He denied

---

[24] *Deibler v. Atl. Properties Group, Inc.,* 652 A.2d 553, 558 (Del.1995) (emphasis added).
[25] *Id.*
[26] Trans. ID 21278987.
[27] *See* footnote 18, *supra.* Chancellor Glasscock attempts to place the blame on Merritt by contending that she did not "ardently propound" advancement at this stage of the case. *Merritt*, p. 24. This is incorrect: Merritt requested advancement during a conference with Chancellor Chandler on August 28, 2008 and repeated her request in a brief filed six days later: "[R&R] cite[s] no reason that this Court should, *inter alia… invalidate [] Merritt's right to advancement of fees and expenses in connection with this litigation as provided for in the operating agreements…*" TransID 21346975, p. 16 n. 9.

advancement on the ground that the right to advancement was a "substantive" matter, and to rule on this matter in Merritt's favor "would be effectively proceeding with this litigation, which the defendants here have successfully argued [in New York] should not be going forward."[28] This rationale flew in the face of § 9.1 of the operating agreements, which required advancement whether or not Delaware proceedings were stayed.

In his third order on July 10, 2009, Chancellor Chandler denied advancement on the ground that advancement of fees was premature "until the Court is able to resolve finally the rights and liabilities and responsibilities of the various parties involved in these entities."[29] Once again, this ran afoul of Delaware decisions which make clear that advancement does not depend on the underlying merits of the member's case.

Chancellor Glasscock's attempts to justify the July 10, 2009 decision do not withstand scrutiny. He suggests that deferral was appropriate because R&R had moved to hold Merritt in contempt

---

[28] Trans ID 24155154, p. 24.
[29] Trans ID 26354286.

for withdrawing $150,000 in cash from the Entities, and Merritt failed to offer any explanation for her withdrawals[30]. This is incorrect. R&R's motion papers show that Merritt did nothing wrong. $118,212 of the alleged misappropriated $150,000 came from Merritt's own personal accounts (identified as Merritt, Merritt Litig, and Mer-Lyn).[31] Essentially, R&R attempted to hold Merritt in contempt for using her own money. Merritt used the balance of the funds, some $32,000, for daily operations of the LLC's (purchase of feed, veterinarian bills and payroll for over thirty horses and approximately 500 acres of land with several dwellings).[32] Merritt stated to the Court, and R&R's counsel conceded, that she had produced "nearly 6000 documents" in support of her position.[33] R&R offered no affidavits under Chancery Rule 70(b) in support of its allegations of improper cash

---

[30] *Merritt*, p. 26.

[31] R&R Contempt Motion, May 8, 2009, p. 18, ¶ 36 (Trans I.D. 25099310). Chancellor Glasscock also suggested that Merritt looted the LLC's in cahoots with her boyfriend, Leonard Pelullo, a convicted criminal. *Merritt*, p. 23. Pelullo, however, had returned to jail in 2005, over three years earlier, so this suggestion of a conspiracy is baseless.

[32] Merritt's Response To R&R's Contempt Motion, p. 8 ¶ 18 (Trans ID 25413003).

[33] Tr. 5/11/09, 8:17; 14:17 (Trans ID 25221305).

withdrawal. Chancellor Chandler decided not to find Merritt in contempt, since the cash withdrawals were within the terms of the status quo order.[34] He merely requested that the parties change the status quo order to require withdrawals by check instead of cash.[35] Since Merritt acted properly, and since Chancellor Chandler found no basis for contempt, this episode did not justify his decision to defer advancement.

Chancellor Glasscock also rationalized the July 2009 order by noting that in April 2009, the Eastern District of Pennsylvania had ruled that Merritt defrauded R&R. Thus, Chancellor Glasscock continued, Chancellor Chandler knew by July 2009 that Merritt would probably be removed for cause and "could not be trusted to safeguard the assets of her litigation adversary, R&R."[36] This reasoning violates (a) the prohibition in this Court's remand order against "considering whether the decision to remove Merritt was correct" while examining the advancement issue and (b) the

---

[34] **Error! Main Document Only.**Tr., 5/11/09, 18:10-13 (Trans ID 25221305).
[35] **Error! Main Document Only.**Tr. 5/11/09, 29:24-30:4 (Trans ID 25221305).
[36] *Merritt*, pp. 24-25.

principle proscribing consideration of the merits of the underlying case while deciding motions for advancement (footnote 14, *supra*).

Significantly, neither R&R's contempt motion nor the Eastern District decision had been filed at the time of Chancellor Chandler's deferral orders in September 2008 and February 2009. Had Chancellor Glasscock reviewed the September 2008 and February 2009 orders, he would not have been able to cite the contempt motion or Eastern District decision as grounds for endorsing these orders, and he would have had no choice but to recommend advancement. Thus, his use of these documents as rationales for endorsing Chancellor Chandler's July 2009 order underscores the harm caused to Merritt by his failure to review the prior orders.

Merritt respectfully requests that she receive advancement in accordance with the Operating Agreements.

Dated: April 12, 2013

Respectfully Submitted:

/S/ Erik C. Grandell
Erik C. Grandell, Esquire
DE Supreme Court #2708
1473 Spruce Avenue
Wilmington, DE 19805
(302) 757-6627

/s/ Thomas D. Schneider
Thomas D. Schneider, Esquire
122 South Providence Road
Wallingford, PA 19086
(610) 565-1134
Admitted *pro hac vice*

Certification of Service

I hereby certify that on April 12, 2013, true and correct copies of the foregoing were caused to be served by Lexis/Nexis E-Service upon:

Richard P. Rollo, Esquire
Richards, Layton & Finger, P.A.
920 N. King Street
Wilmington, DE 19801
(302) 651-7700

/s/ Erik C. Grandell, Esquire
Erik C. Grandell, Esquire
DE Supreme Court # 2708