EFiled: Jun 21 2012 11:41PM EDT
Filing ID 44960178
Case Number 144,2011

IN THE SUPREME COURT OF THE STATE OF DELAWARE

LINDA MERRITT, Defendant below, Appellant, v. R&R CAPITAL, *et al.*, Plaintiffs below, Appellees,	)	No. 144,2011 Court Below: Court of Chancery (C.A. No. 3989)

PLAINTIFFS' BELOW, APPELLEES' ANSWERING BRIEF ON APPEAL

OF COUNSEL:

Paul Sweeney
Certilman Balin, Adler & Hyman, LLP
90 Merrick Ave
East Meadow, NY 11554
(516) 296-7000

Richard P. Rollo (#3994)
Nicole C. Bright (#5311)
Richards, Layton & Finger, P.A.
920 North King Street
Wilmington, DE 19801
(302) 651-7700

Attorneys for Plaintiffs' Below, Appellees

Dated: June 21, 2012

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NATURE OF PROCEEDINGS

This appeal arises out of a dispute concerning the continued operation and management of various Delaware limited liability companies formed to invest in real estate and horses ("LLCs"). Appellees R&R Capital LLC and FTP Capital LLC (collectively, "R&R") contributed the bulk of the initial capital (over $9.7 million), and Appellant Linda Merritt ("Merritt") was the manager of the LLCs.

The relationship between the parties deteriorated and, as a result, they have been litigating against each other for more than six years in New York, Pennsylvania and Delaware (both federal and state courts). There have been numerous appeals, a bad faith bankruptcy filing by Merritt and at least one writ of certiorari to the U.S. Supreme Court. Despite the convoluted procedural history, the core dispute concerns the proper interpretation of a manager removal provision in the LLCs' operating agreements ("LLC Agreements").

On August 20, 2008, R&R provided Merritt notice of her removal as manager of the LLCs for "Cause" ("2008 Removal Notice"). Contemporaneously, R&R sought a declaration from the Court of Chancery ("Trial Court") that Merritt had been validly removed as manager of the LLCs as of August 20, 2008. Merritt contested her removal.

In relevant part, the LLC Agreements state the basis for a manager's removal for "Cause" as follows:

> The Manager may be removed as Manager for "Cause" upon the written demand of [R&R]. Such written demand shall set forth with specificity the facts giving rise to such Cause. As used herein, a removal for **"Cause" shall mean that the Manager to be removed shall have (a) engaged in fraud** or embezzlement, (b) committed an act of dishonesty, gross negligence, willful misconduct, or

> malfeasance that has had a material adverse effect on the Company or any other Member, or (c) been convicted of any felony.

("Section 4.5").[1] When the 2008 Removal Notice was tendered, an action was pending in the U.S. District Court, Eastern District of Pennsylvania, styled *R&R Capital v. Merritt*, C.A. No. 06-1544 ("PA Pinhooking Action"), involving a dispute over the possession and ownership of three pinhooking horses. The 2008 Removal Notice was based, in part, upon Merritt's conduct at issue in the PA Pinhooking Action.

On April 17, 2009, an opinion was issued in the PA Pinhooking Action ("PA Fraud Opinion"), which expressly found that Merritt engaged in fraud against R&R prior to the 2008 Removal Notice. In light of that finding, there is no longer a question concerning whether Merritt, in fact, "engaged in fraud," and Merritt is collaterally estopped from contesting the issue. In terms of Merritt's removal as manager, the PA Fraud Opinion unequivocally established that a contractual basis existed for Merritt's removal for "Cause" under Section 4.5(a) as of August 20, 2008. Thus, summary judgment was appropriately granted against Merritt by the Trial Court.

While R&R will address the remaining arguments in Merritt's opening appeal brief ("Opening Brief"; cited "OB [page]"), Merritt's arguments are largely obfuscation and misdirection. The Opening Brief

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[1] (emphasis added unless otherwise noted). The defined terms in the LLC Agreements differ slightly (*e.g.*, some refer to a Manager, while others refer to a Managing Member), and the removal provision is contained in Section 3.5 for certain LLCs (as opposed to Section 4.5). However, substantively, the provisions are identical, so R&R refers to the relevant removal provisions generically as Section 4.5.

materially misstates the record below[2] and the issues properly presented by this appeal, which is unsurprising given that courts have characterized Merritt's assertions as "unsupported," "inaccurate," "fraudulent" and "not credible," and her litigation tactics as lacking good faith.[3] Given the foregoing, the numerous assertions in the Opening Brief that lack record citations should either be ignored outright or read with a healthy dose of skepticism.

Finally, with respect to Merritt's attack of former Chancellor Chandler, it patently lacks merit. The Trial Court's comments to Merritt concerning her tactic of pressing these types of baseless recusal claims apply equally here:

> [W]hen you hurl accusations of that kind without credible support for them, it really creates an inference that you now are really acting in bad faith, that you no longer are willing to abide by the rules of the legal system. You are now outside of the legal system and resorting to any type of canard, malicious statement, or just unsupported statements that you can think of in order to achieve some objective that you have.[4]

* * *

For the reasons set forth herein, Merritt's appeal should be denied and the Trial Court's rulings affirmed.

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[2] *Compare, e.g.*, OB 21 (claiming Merritt's removal was "*sua sponte* and not requested by R&R"), *with* B-435 - B-436 (R&R's amended complaint, at Count I, seeking declaration that Merritt's removal was valid).

[3] *See, e.g.*, B-1172 (2009 finding, after trial, that "**statements by … Merritt … were … fraudulent**"); A-816 (noting to Merritt: "I am not persuaded by your arguments or assertions, most of which are **wholly unsupported** and **many of which are plainly inaccurate**"); B-2208 - B-2209 (2010 order dismissing bankruptcy due to Merritt's "**lack of good faith**"); A1148 (Feb. 21, 2011 final transcript in which Merritt admitted: "So my testimony, **the judge found it not credible**."); *id.* at A-1225 (Court to Merritt: "I really question … the good faith and integrity with which you bring this motion on.").

[4] A-1226-A-1227.

SUMMARY OF ARGUMENT

1. Denied. First, the Opening Brief misstates the issue on appeal. The Trial Court did not decide the substantive question of whether Merritt had a valid contractual right to advancement pursuant to the LLC Agreements. To the contrary, on July 10, 2009, the Trial Court simply denied a motion to modify the existing September 8, 2008, *status quo* order to permit Merritt to use or sell the LLCs' assets to advance herself attorneys' fees in connection with the action below ("Status Quo Ruling"). Merritt's purported contractual right to advancement was (and is) disputed because any contractual right to advancement terminated as of August 20, 2008 (the date of her removal) under the unambiguous terms of the LLC Agreements. As reflected in the transcript ruling, the Trial Court concluded that it would be imprudent to authorize advancement to anyone (either Merritt or R&R - both of whom claimed to be the valid manager) before determining their status, rights and responsibilities. The Trial Court's subsequent summary judgment opinion confirmed that Merritt did not have a valid contractual right to advancement as of the Status Quo Ruling. Second, Merritt's *res judicata* claim is unfounded because (i) the LLCs were not parties to the New York proceedings, and (ii) the January 4, 2008, New York order identified in the Opening Brief (A-572-A-579) related to indemnification (not advancement) rights prior to Merritt's removal as manager. Third, even assuming the Status Quo Ruling was erroneous, that error was harmless (assuming that Merritt's removal was valid).

2. Denied. First, the Trial Court's interpretation of the unambiguous language in Section 4.5(a) was correct as a matter of law.

While Merritt argues that the phrase "engaged in fraud" is somehow qualified by the phrase "related to the LLCs" or "resulting in a material adverse effect on the [LLC] or any other Member," her contention is inconsistent with the plain meaning of the words on the page. Second, Merritt's *res judicata*/collateral estoppel argument concerning her removal is, ironically, barred by the doctrine of *res judicata*. The New York First Department Appellate Division ("NY First Dept") has repeatedly held that the DE Actions do not overlap with the New York proceedings. Those decisions bind Merritt, who is a party to the New York proceedings.

3. Denied. First, the record reflects that Merritt repeatedly violated multiple Trial Court orders. During the June 25, 2010 contempt hearing ("Contempt Hearing"), after considering the parties' written submissions and oral argument, the Trial Court (i) ordered Merritt, among other things, to vacate a farm leased by the LLCs ("Farm") and provided her a deadline for doing so, (ii) confirmed that Merritt understood the Trial Court's order, then (iii) explained the consequences if Merritt failed to comply. The Trial Court clearly intended to coerce Merritt's compliance. Nevertheless, Merritt failed to comply and, on June 28, 2010, the Trial Court entered its contempt order ("Contempt Order"). Second, Merritt's "procedural" claims attempt to elevate form over substance. The Contempt Order was supported by (i) documentary evidence, (ii) oral and written representations by the court-appointed receiver that were subject to Rule 11, and (iii) oral and written representations by Merritt that were subject to Rule 11. Moreover, Merritt directly answered the

Trial Court's questions during the Contempt Hearing. It is readily apparent that the Trial Court had ample support for the Contempt Order. Third, while Merritt claims that the sanction imposed upon her by the Contempt Order (stripping her of her interests in the LLCs) was "in excess of $15 million," that claim lacks any evidentiary support in the record. The foregoing fact is noteworthy because Merritt was compelled by the Trial Court to produce all relevant documents and information. In light of the foregoing, Merritt cannot fairly assert that she has evidence - outside of the record - to support her claimed damages. As for the evidence actually contained in the record, the minimal value remaining in the LLCs belonged solely to R&R, as found by the court-appointed forensic accountant who corroborated over $8 million contributed by R&R but was unable to corroborate any of Merritt's alleged contributions to the LLCs.

4. Denied. Merritt's claim that Chancellor Chandler's employment with Wilson Sonsini (after leaving the bench in April 2011) somehow creates an image of impropriety concerning his decisions regarding the receivership (which ended in February 2011), or his Contempt Order (in June 2010), or his Summary Judgment Opinion (in September 2009) is, in a word, laughable. Merritt's argument is the latest in a string of baseless accusations against the Trial Court, the court-appointed receiver and R&R's counsel. This litigation tactic by Merritt should not be condoned (or permitted to proceed further).

COUNTER STATEMENT OF FACTS

A. The Delaware Proceedings.

There were two actions before the Trial Court involving these parties: C.A. No. 3803 ("DE Dissolution Action") and C.A. No. 3989 ("DE Removal Action"; collectively, "DE Actions"). Both DE Actions arose out of a dispute among the parties concerning the continued operation and management of the LLCs by Merritt. While the DE Actions are related, this appeal relates to the later-filed DE Removal Action.

1. The DE Dissolution Action.

R&R filed the DE Dissolution Action on June 2, 2008, and sought to have the LLCs wound up and dissolved by a neutral third party pursuant to Sections 18-802, 18-803 and/or 18-805 of the Delaware LLC Act.[5] Although the LLC Agreements waived the members' rights "to seek a court decree of dissolution or to seek the appointment by a court of a liquidator for the Company,"[6] R&R argued that the waivers were unenforceable (an issue of first impression). At the time, the leading treatises supported R&R's position.[7]

On June 12, 2008, over Merritt's objection, the Trial Court entered a *status quo* order[8] in a form typically used in the analogous context of proceedings under 8 *Del. C.* § 225. R&R argued that a *status quo* order was necessary to prevent Merritt from wrongfully dissipating the LLCs' assets - including $1.68M in LLC funds that were being held in escrow by a Pennsylvania court ("$1.68M PA Escrow").[9] In

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[5] B-1 - B-17 (petition for dissolution).
[6] B-185.
[7] B-71 - B-76 (motion to dismiss opposition).
[8] B-30 - B-31 (letter ruling), B-26 - B-29 (order).
[9] B-20 - B-22 (motion for status quo order).

support of that claim, R&R's *status quo* motion described prior wrongful dissipation of funds by Merritt and troubling activity reflected in the LLCs' financial records. With regard to latter, R&R noted that (as of November 2006) there were in excess of 1,600 intra-LLC transactions orchestrated by Merritt and her longtime boyfriend Leonard Pelullo ("Pelullo"), who was convicted of fraud, racketeering, embezzlement of union pension funds and money laundering, and is currently serving a lengthy prison sentence. As described in a suspicious activity report summary:

> [Merritt's] personal account seems to be funded mostly by checks deposited that are drawn on the business accounts. Of concern are the very large dollar amounts and high volume of incoming wires and the constant, unusual movement of money between accounts that do not appear to have a sound business reason.... The customer's explanation for the complicated way in which she moves money around, is because her accountant wants it that way. Another unusual aspect is that her fiancé [Pelullo] always calls in the transfers, even though he is told on every call that we cannot do anything or talk about the account with him because he is not a signer on the account. He insists on giving the instructions for moving the money around and then puts [Merritt] on the phone to okay the requests.[10]

The pattern of transactions among the LLCs is remarkably similar to the activities for which Pelullo was convicted. As described by Judge Debevoise, who presided over Pelullo's federal criminal trial:

> Pelullo's method of operation was to conduct his multitudinous business and personal transactions through a host of corporate and partnership entities and through a dizzying succession of wire transfers, both necessary and unnecessary to accomplish an objective. As a result Pelullo was able to conceal the nature of his undertaking,

[10] B-16.

> and deceive those with whom he was dealing .... No one but Pelullo could comprehend it all in its entirety. He alone, an obviously highly intelligent person, was able to keep track of it all and manipulate it to his advantage.[11]

R&R alleged (and believes) that Pelullo was making decisions related to the LLCs from his prison cell – using Merritt as a "front-person."[12]

While R&R will not burden this Court with a full description of Merritt's attempts to circumvent that *status quo* order (which were designed, in part, to access the $1.68M PA Escrow), it is worth noting that the Trial Court directly instructed Merritt's counsel how to challenge the *status quo* order if Merritt believed it was improper:

> What I've done is enter that *status quo* order. **If you want to challenge that, provide me with an interlocutory appeal order. I'll sign it in a heartbeat. You can go to the Delaware Supreme Court and get it reversed if you think that's the best course.** But if not, that order is hanging out there….[13]

Nevertheless, Merritt did not seek an interlocutory appeal.

On August 19, 2008, the Trial Court dismissed a majority of the DE Dissolution Action based upon a finding that the contractual waiver of judicial dissolution was enforceable.[14] The scope of the *status quo* order was subsequently limited to two of the LLCs.

2. The DE Removal Action.

On August 20, 2008, R&R tendered the 2008 Removal Notice, which removed Merritt as manager of the LLCs for "Cause" and elected to pay

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[11] *United States v. Pelullo*, 961 F.Supp. 736, 750-53 (D.N.J. 1997) (quoted in *United States v. Pelullo*, 399 F.3d 197 (3d Cir 2005)).

[12] *Accord* B-50 (confirming ruling that Merritt was a "front person" for Pelullo).

[13] B-119 (July 31, 2008 transcript).

[14] B-124 - B-147 (August 19, 2008 memorandum opinion).

Merritt the balance of her relevant capital accounts in exchange for her membership interests pursuant to Section 4.5 of the LLC Agreements. The 2008 Removal Notice was based, in part, upon Merritt's conduct at issue in the PA Pinhooking Action.[15]

Contemporaneous with the 2008 Removal Notice, R&R filed the DE Removal Action, which, in part, sought a declaration that Merritt had been validly removed as manager of the LLCs. R&R also moved for an order preserving the *status quo* pending the Trial Court's final determination - articulating the same concerns identified above concerning the threat of dissipation by Merritt.

During a telephonic hearing on August 28, 2008, Merritt's counsel specifically argued that the form of *status quo* order (if any) entered in the DE Removal Action should have a carve-out for "advancement of attorneys' fees" to Merritt.[16] The Trial Court reserved judgment and directed the parties to complete briefing on the *status quo* motion.[17]

Merritt's answering brief argued, among other things, that R&R could not prevail on the removal claims "because a previous decision of the Supreme Court of New York in the New York Action collaterally estops them from obtaining that declaratory relief from this Court."[18] However, Merritt's answering brief did not assert - and therefore

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[15] *See* B-431 ("The facts detailed in the Plaintiffs' filings in the foregoing action in Pennsylvania are expressly incorporated herein by reference."); B-417 (stating same).

[16] B-457 - B-458 (August 28, 2008 transcript).

[17] B-439 (August 28, 2008 letter).

[18] B-703 - B-706.

waived[19] - the argument that Merritt's counsel raised during the August 28 hearing that the form of *status quo* order (if any) entered in the DE Removal Action should have a carve-out for the "advancement of attorneys' fees" to Merritt.

R&R's reply brief responded to Merritt's arguments and provided the Trial Court with the relevant filings in New York for comparison.[20]

On September 8, 2008, the Trial Court entered a *status quo* order in the DE Removal Action.[21] The form of *status quo* order entered was virtually identical to the original *status quo* order in the DE Dissolution Action. Merritt did not timely appeal entry of the DE Removal Action *status quo* order. Instead, she engaged in a series of legal maneuvers (largely in other courts) aimed at circumventing the *status quo* order and terminating further proceedings in Delaware. Merritt's efforts were described at length in R&R's January 30, 2009, letter to the Trial Court (incorporated herein by reference).[22]

3. The 2008 New York Injunction Caused The Trial Court To Stay Substantive Proceedings In The DE Removal Action.

While the motion for a *status quo* order was pending in the DE Removal Action, Merritt filed a motion before Justice Charles E. Ramos of the New York Supreme Court seeking an injunction prohibiting R&R from any further action, such as the DE Actions, that may have the

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[19] *See, e.g., Hokanson v. Petty,* 2008 WL 5169633 at *6 n.22 (Del. Ch. Dec. 10, 2008); *Emerald Partners v. Berlin,* 726 A.2d 1215, 1225 (Del. 1999).

[20] B-716 - B-963.

[21] *See* A-131 - A-134.

[22] B1014 - B1063 (Jan. 30, 2009, Rollo letter) (explaining, in part, Merritt's removal to, and remand from, the District of Delaware; her efforts to access the $1.68M PA Escrow; and injunction proceedings in New York).

effect of interfering with "Merritt's ability to manage the LLCs" unless such action is "directed to [the New York] Court."[23]

On October 16, 2008, Merritt's counsel reargued her claim that the DE Actions were barred by the doctrine of collateral estoppel[24] and convinced the New York court to grant an injunction prohibiting R&R from pursuing the DE Actions.[25] Justice Ramos concluded that the DE Actions had been brought, "in part, in bad faith" and required R&R to withdraw them ("New York Injunction").

R&R promptly filed a notice of appeal in the NY First Dept ("New York Injunction Appeal"), and the New York Injunction was stayed pending resolution of that appeal.[26] As discussed below, R&R's New York Injunction Appeal was ultimately successful, and the New York Injunction was vacated.

In January 2009, Merritt moved the Trial Court to stay the DE Actions pending resolution of the New York Injunction Appeal.[27] In addition, Merritt moved to modify the *status quo* order to permit the use or sale of the LLCs' assets to advance herself attorneys' fees in connection with the Delaware Actions.[28] R&R opposed both motions and contested Merritt's purported contractual right to advancement, arguing that any such contractual right terminated as of August 20, 2008:

> [A]lthough Merritt claims a right to advancement and indemnification in the current scenario,

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[23] *See* B-490 - B-495.
[24] B-1032.
[25] *See, e.g.*, B-1043, B-1044, B-1045 - B-1046.
[26] B-1063.
[27] B-964 - B-970.
[28] B-971 - B-1013.

> **[R&R] do[es] not agree that such rights currently exist[]**, or that the requested payments would be appropriate (ahead of other pre-existing obligations of the [LLCs]).[fn 35] **The *status quo* order should not be amended prior to a determination that Merritt is, in fact, contractually entitled to advancement**.
>
> [footnote 35] For example, the LLC Agreement … states that "a Managing Member that has been removed for Cause pursuant to this Section 4.5 shall be deemed removed on the date of delivery of the written demand required by the first sentence of this Section 4.5, and **such removal shall immediately terminate all of such Managing Member's [*i.e.*, Merritt'] rights and privileges hereunder**, other than the right to receive the payments required by this Section 4.5." (emphasis added). Merritt's claim to advancement is based upon a right she claims exists under the LLC. While there is a carve-out for payments pursuant to Section 4.5, there is no carve-out for payments pursuant to Section 9.1 (advancement). **Thus, under the plain language of the LLC Agreement, any right that Merritt might have had to advancement of legal fees terminated as of August 20**.[29]

On February 25, 2009, after oral argument, the Trial Court stayed further substantive proceedings in Delaware pending resolution of R&R's New York Injunction Appeal ("Delaware Stay"). With regard to Merritt's pending motion to modify the *status quo* order, the Trial Court explained that resolution of the motion required substantive determinations and, as such, it was subject to the Delaware Stay:

> [S]ince [Merritt's Counsel] has persuaded me that I should, out of respect for Justice Ramos' decision, effectively honor his injunction, it seems to me that I have to do that completely **with respect to all the substantive matters that are before me, which includes the motion to modify the *status quo* order, the motion to pay attorneys' fees and to order advancement rights. All of those matters are substantive in nature,**

[29] B-1023 - B-1024.

> and to rule on those in favor of [Merritt] would be effectively proceeding with this litigation ....[30]

Merritt did not appeal the above Trial Court ruling.

4. The PA Fraud Opinion Found That Merritt Engaged In Fraud Prior To The 2008 Removal Notice.

As noted above, the PA Fraud Opinion in the PA Pinhooking Action expressly found that Merritt engaged in fraud against R&R prior to August 20, 2008 (the date of the 2008 Removal Notice):

> R&R was induced to purchase Lipstick/Pulpit on the basis of **statements by** Pelullo and **Merritt that were both fraudulent and material**. Pelullo, who was Merritt's employee and who handled the details of the sale for her, told the Russacks that the three pinhooking horses that R&R was purchasing were "the three best yearlings" that they could purchase, even though Pelullo knew that Merritt had attempted to return Lipstick/Pulpit to Fasig-Tipton on the basis of Dr. Reid's diagnosis of laminitis. Neither Pelullo nor Merritt disclosed to the Russacks that Merritt had sought to return the horse, or disclosed that the horse was lame, or disclosed the August 2004 report of Dr. Reid or the New Bolton veterinarians' October 2004 report. **In these circumstances, the statement** that Lipstick/Pulpit was one of the best horses available was a **knowing misstatement not in accord with the facts and therefore fraudulent**.[31]

Although the PA Fraud Opinion conclusively established that "Cause" for Merritt's removal as manager existed under Section 4.5(a), R&R was not able to substantively press forward with the DE Removal Action due to the Delaware Stay.

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[30] B-1087 (Feb. 25, 2009 transcript); *see also* B-1091 - B-1092(letter order).

[31] B-1172.

5. Merritt Moved To Modify The *Status Quo* Order.

On June 16, 2009, notwithstanding the Delaware Stay, Merritt filed a "renewed" motion to modify the *status quo* order to permit the use or sale of the LLCs' assets to advance herself attorneys' fees in connection with the Delaware Actions.[32] Notably, Merritt's motion did not address R&R's argument (discussed above) that her contractual right to advancement terminated as of August 20, 2008, under the plain language of the LLC Agreements.

6. The 2008 New York Injunction Was Reversed.

On June 23, 2009, the NY First Dept unanimously reversed and vacated the New York Injunction, stating:

> The [New York] court lacked jurisdiction to order [R&R] to withdraw claims pending in the state courts of Pennsylvania and Delaware, since, as we recently found in the companion appeal, **"the relief sought did not relate to a cause of action raised in the initial complaint, nor was the issue involved previously litigated in this action"** (60 AD3d 528, 529 [2009]).[33] Furthermore, the order improperly intrudes on the jurisdiction of the Delaware and Pennsylvania courts, in violation of established principles of comity (*see Ackerman v Ackerman*, 219 AD2d 515 [1995]). **There is no basis for the court's finding that the Delaware and Pennsylvania actions were brought in bad faith or with an intent to harass defendant [Merritt].**[34]

The NY First Dept ruling is the law of the case in New York and it binds Merritt (who is a party to the New York proceedings).

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[32] B-1099 - B-1111. Merritt had previously filed a motion to modify the *status quo* order after the Delaware Stay, B-1093 - B-1096, which was denied, B-1097 - B-1098. Merritt did not appeal that Trial Court ruling.

[33] This is a reference to a NY First Dept order, dated March 19, 2008, which vacated a separate order by Justice Ramos that purported to allow Merritt to disburse the $1.68M PA Escrow. *See* B-1132 - B-1133.

[34] B-1115 - B-1116.

7. The Trial Court Lifts The Delaware Stay, Denies Merritt's Renewed Motion To Modify The *Status Quo* Order, And Proceeds With Summary Judgment Briefing.

On June 30, 2009, R&R moved to lift the Delaware Stay and for summary judgment in the Delaware Removal Action ("Summary Judgment Motion").[35]

On July 10, 2009, the Trial Court vacated the Delaware Stay and permitted R&R to proceed with the DE Actions.[36] During the telephonic hearing, the Trial Court also denied Merritt's "renewed" request to modify the *status quo* order, stating:

> My view is that no one should be advanced any fees in this litigation - neither Merritt nor any of [R&R] who have brought the actions - until the Court is able to resolve finally the rights and liabilities and responsibilities of the various parties involved in these entities. Whether or not parties should remain as managing members, whether they should remain as members and what the respective responsibilities of the various members are in these entities is an open question. And my view is that it would be imprudent to order or authorize advancement of fees before the Court has made those ultimate determinations. And so based on that reasoning, I deny the motion to modify the *status quo* order to authorize or permit advancement of attorneys' fees to Ms. Merritt.[37]

The Status Quo Ruling is consistent with R&R's objection to Merritt's January 2009 motion to modify the *status quo* order - *i.e.*, the *status quo* order should not be amended prior to a determination that Merritt is, in fact, contractually entitled to advancement.

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[35] B-1117 - B-1213.
[36] A-191.
[37] A-193.

8. The Trial Court Enters Summary Judgment.

The parties completed briefing on R&R's Summary Judgment Motion by July 31, 2009.[38] Nevertheless, in the weeks that followed, Merritt submitted numerous sur-replies to the Trial Court, including a purported motion for summary judgment.[39] Generally speaking, R&R did not substantively respond to those filings because they violated Court of Chancery Rule 171(a).[40] In total, Merritt burdened the Trial Court with approximately 900 pages of argument and 1600 pages of material in opposition to the Summary Judgment Motion.[41]

On September 3, 2009, the Trial Court concluded that oral argument was unnecessary and granted summary judgment on Count I of the Delaware Removal Action ("Summary Judgment Opinion").[42] In connection with the foregoing, on September 14, 2009, the Trial Court entered an implementing order ("Implementing Order") that appointed

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[38] A-210 - A-671(answering brief); B-1214 - B-1972 (reply brief).

[39] *See, e.g.*, B-1973 - B-1986 (Aug. 3, 2009 letter); B-1987 - B-2008 (Aug. 6, 2009 letter); B-2011 - B-2015 (Aug. 7, 2009 letter); B-2016 - B-2017, A-715 - A-800(Aug. 18, 2009 letter and Aug. 19, 2009 brief); B-2018 - B-2021 (Aug. 21, 2009 letter); B-2022 - B-2026(Aug. 31, 2009 letter); B-2027 - B-2028 (Sept. 2, 2009 letter).

[40] *See, e.g.*, B-2009 - B-2010 (Aug. 6, 2009 Rollo letter).

[41] Merritt's strategy of flooding the Trial Court with repetitive, oversized and baseless submissions is consistent with the litigation strategy previously employed by her fiancé Pelullo in his criminal proceedings. *See, e.g., United States v. Pelullo*, 2008 WL 4601655, at *14 (D.N.J. Oct. 14, 2008) (stating that "Pelullo has been deluging the court with a blizzard of motions and a rising mountain of supporting documents" then proceeding to deny all of Pelullo's pending motions).

[42] A-801 - A-808. Note that Merritt initially refused to acknowledge the validity of the ruling. B-2029 - B-2042 (Sept. 4, 2009 letter).

Kurt M. Heyman, Esq., to act as a receiver ("Receiver") to wind up and dissolve the LLCs ("Receivership").[43]

9. Merritt Sought To Obstruct The Receivership And Circumvent The Summary Judgment Opinion.

While R&R will not burden this Court with a full description of Merritt's attempts to circumvent the Summary Judgment Opinion, it is fair to say that the ruling triggered another avalanche of filings by Merritt in the Trial Court and elsewhere. Among other things, Merritt (i) attempted to collaterally attack the Trial Court ruling by asserting new claims in New York that overlap with the already decided claims in the DE Actions,[44] (ii) obstructed the Receivership through, among other things, the filing of a bankruptcy proceeding expressly found by the Bankruptcy Court not to have been filed in good faith,[45] and (iii) pursued multiple unsuccessful appeals to this Court.[46]

Ultimately, the Trial Court found Merritt in contempt of court, the Receiver completed his work, and the LLCs were canceled. To the

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[43] A-813 - A-815.

[44] *See, e.g.*, B-2116 - B-2119 (Merritt April 6 Letter); B-2120 - B2139 (Rollo April 13 Letter); A-937 (order).

[45] *See, e.g.*, B-2110 - B-2113(receiver's motion for injunctive relief against Merritt); B-2140 - B-2154(receiver's motion for contempt against Merritt); B-1112 - B-1116 (attaching July 9, 2010 Order dismissing the bankruptcy petition due to the *"Debtor's lack of good faith in filing the petition"*).

[46] *See, e.g.*, B-2047 - B-2049 (Case No. 529,2009) (challenging four trial court orders, including the September 2009 partial summary judgment, and denial of advancement); B-2054 - B-2089 (Case No. 529,2009) (Merritt's brief challenging denial of advancement and alleging R&R made false representations to the New York Appellate Court); B-2090 - B-2094 (order dismissing Case No. 529,2009); B-2095 - B-2096 (Case No. 598,2009) (separate appeal challenging September 12, 2009, trial court order denying various requests by Merritt, including to vacate or stay the September 2009 partial summary judgment); B-2101 - B-2102 (order dismissing Case No. 598,2009); *see also* B-2045 - B-2046 (Case No. 529,2009) (opposition to motion for expedition) (addressing Merritt's advancement arguments).

extent facts related to the foregoing are relevant to this appeal, they will be discussed in the appropriate argument sections below.

ARGUMENT

I. SUMMARY JUDGMENT WAS PROPERLY GRANTED TO CONFIRM MERRITT'S REMOVAL AS OF AUGUST 20, 2008 (OB 20).

A. Question Presented.

Whether the Trial erred by granting summary judgment to confirm the validity of Merritt's removal as of August 20, 2008.

B. Scope of Review.

This Court reviews *de novo* an order from the Court of Chancery granting summary judgment pursuant to Rule 56.[47] This Court will also review *de novo* a trial court's "formulation and application of legal principles."[48] While the facts in the record must be viewed in the light most favorable to the non-moving party,[49] the moving party "is entitled to judgment as a matter of law where the facts permit a reasonable person to draw only one inference" from them.[50]

C. Merits of Argument.

The Trial Court properly granted summary judgment because (i) Section 4.5(a) is unambiguous, (ii) the PA Fraud Opinion conclusively established that "Cause" existed, and (iii) Merritt's *res judicata* claim concerning the pinhooking dispute is baseless (and barred).

1. Section 4.5(a) Is Unambiguous.

Under Delaware law, "LLC Agreements are contracts to be construed like any other contract."[51] It is well established that Delaware

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[47] *Reddy v. MBKS Co., Ltd.*, 945 A.2d 1080, 1085 (Del. 2008).

[48] *Id.*

[49] *Id.* at 1081 n.2.

[50] *Cash v. E. Coast Mgmt., Inc.*, 2010 WL 4272925, at *1 (Del. Oct. 29, 2010) (TABLE).

[51] *Arbor Place, L.P. v. Encore Opportunity Fund, L.L.C.*, 2002 WL 205681, at *3 (Del. Ch. Jan. 29, 2002).

courts follow the objective theory of contract interpretation.[52] Thus, when interpreting a contract, a court will "stand[] in the shoes of an objectively reasonable third-party" and ascertain whether the language of the contract is clear.[53] Where the unambiguous language of a contract is only susceptible to one reasonable interpretation, summary judgment is appropriate.[54]

Merritt's removal was based upon the below-underlined language in Section 4.5(a):

> The Manager may be removed as Manager for "Cause" upon the written demand of [Appellees]. Such written demand shall set forth with specificity the facts giving rise to such Cause. As used herein, a removal for "Cause" shall mean that the Manager to be removed shall have **(a)** **engaged in fraud** or embezzlement, **(b)** committed an act of dishonesty, gross negligence, willful misconduct, or malfeasance that has had a material adverse effect on the Company or any other Member, or **(c)** been convicted of any felony.[55]

Notably, there are no limitations or qualifications on the term "fraud."[56] Thus, the only reasonable interpretation is that *any and all* fraud by the manager (*i.e.*, Merritt) can serve as grounds for removal for "Cause." There are no other reasonable interpretations.

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[52] *See Seidensticker v. Gasparilla Inn, Inc.*, 2007 WL 4054473, at *3 (Del. Ch. Nov. 8, 2007) (referring to "Delaware's stalwart and longstanding adherence to an objective theory of contracts").

[53] *Dittrick v. Chalfant*, 948 A.2d 400, 406 (Del. Ch. 2007), *aff'd*, 935 A.2d 255 (Del. 2007) (TABLE).

[54] *See Seidensticker*, 2007 WL 4054473, at *3 ("Where a contract term is objectively clear and there is only one 'reasonable interpretation,' it is well within the province of this Court to rule as a matter of law."). A contract provision is not ambiguous simply because the parties disagree on its meaning. *E.I. du Pont de Nemours & Co. v. Allstate Ins. Co.*, 693 A.2d 1059, 1061 (Del. 1997). "Rather, a contract is ambiguous only when the provisions in controversy are reasonably or fairly susceptible [to] different interpretations or may have two or more different meanings." (quotations omitted) *Id.*

[55] *See, e.g.*, B-162 - B-195 (Buck and Doe operating agreement).

[56] B-1227.

Nevertheless, Merritt argues that Section 4.5(a) is limited to fraud (i) relating to the LLCs, or (ii) that results in "a material adverse effect on the [LLCs] or any other Member" (*i.e.*, the limitation contained in Section 4.5(b).[57] Merritt's interpretation is simply inconsistent with the plain meaning of the language in Section 4.5(a).[58] For example, as a grammatical matter, the qualifying "material adverse effect" language clearly applies to Section 4.5(b) only.[59] More fundamentally, if Merritt's interpretation were correct, there would be no reason to separate the conduct articulated in Section 4.5(a) (fraud or embezzlement) from that listed in Section 4.5(b) (dishonesty, gross negligence, willful misconduct, or malfeasance). Indeed, Section 4.4 (addressing the liability of the Managing Member) does not treat that conduct separately.[60] The only objectively reasonable interpretation is that the parties used

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[57] *Compare* OB 19 *with* B-1227 (SJ reply brief).

[58] OB 19; *see Cont'l Ins. Co. v. Rutledge & Co.*, 750 A.2d 1219, 1236 (Del. Ch. 2000) ("Where the parties have created an unambiguous integrated written statement of their agreement, the clear meaning rule instructs courts to enforce the plain meaning of contractual language as understood by a hypothetical third party.").

[59] However, note that the Summary Judgment Opinion found that Merritt's fraud had a material adverse effect on R&R. A-806 ("Even if I believed that the 'material adverse effect' language found in Section 4.5(b) applied to Section 4.5 in its entirety, Merritt would still not receive the outcome that she desires. In such a scenario, the full language of Section 4.5 would then be interpreted to read that the fraudulent act must have 'had a material adverse effect on the Company *or any other Member*.' Merritt's fraudulent conduct, however, was directed toward the plaintiffs—other members of the Entities. Clearly this action falls under the plain meaning of the 'material adverse effect' language in that members of the Entities were materially harmed by Merritt's fraudulent acts.") (emphasis in original).

[60] *See, e.g.*, B-173 (Buck and Doe operating agreement) at § 4.4 (referring to an act that "(a) involves the [Managing Member's] bad faith, gross negligence, willful misconduct or fraud, or (b) resulted in actual, material damage to the Company or a Member.").

different grammatical structure in Sections 4.4 and 4.5 to convey different meanings.

With regard to Merritt's argument that absence of the term "any" from Sections 4.5(a) and (b) somehow demonstrates that these subsections are limited to conduct "in the performance of Managing Member duties or harm against the Entity or a Member in his capacity as a [M]ember of an Entity" - it is not an objectively reasonable interpretation. First, had the parties intended Section 4.5 to differentiate between acts taken in the Managing Member's official capacity and other capacities, they could have expressly done so - as they did elsewhere in the LLC Agreements.[61] Second, in Delaware (as in other states) there are several classes of felony.[62] In that context, the qualifier "any" in Section 4.5(c) makes clear that the general reference includes every class. However, people do not generally refer to different types of "fraud" or "embezzlement" or "dishonesty" or "gross negligence" or "willful misconduct" or "malfeasance," so the qualifier "any" is not typically used. Third, Merritt's interpretation would imply a limitation on the term "fraud" that is not reflected in the express language of Section 4.5(a).

As the Trial Court concluded:

> The more straightforward and grammatical reading of Section 4.5 leads to the correct interpretation – once it has been established that a member has committed fraud, the other

[61] *See, e.g., id.* at § 9.2 (differentiating between "action in [a] Party's official capacity and to action in another capacity").

[62] *See, e.g.,* 11 *Del. C.* § 4205 (sentencing guidelines for Class A to Class G felonies).

> members can remove that member as manager of the LLCs for cause.[63]

Section 4.5 is not susceptible to any other reasonable interpretation.

2. The PA Fraud Opinion Conclusively Established That "Cause" Existed Under Section 4.5(a).

The PA Fraud Opinion specifically found that Merritt engaged in fraud against R&R prior to the 2008 Removal Notice.[64] Under the doctrine of collateral estoppel, Merritt was precluded from challenging that finding before the Trial Court. Delaware Courts look to the law of the adjudicating jurisdiction when addressing questions of collateral estoppel.[65] The PA Pinhooking Action was before a federal court based upon diversity jurisdiction and, as such, Pennsylvania state law governs the collateral estoppel issue.[66]

Under Pennsylvania law, collateral estoppel applies when:

> (1) the issue decided in the prior adjudication was identical with the one presented in the later action; (2) there was a final judgment on the merits; (3) the party against whom the [judgment] is asserted was a party or in privity with a party to the prior adjudication; and (4) the party against whom it is asserted has had a full and fair opportunity to litigate the issue in question in a prior action."[67]

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[63] *Merritt*, C.A. No. 3989-CC, at 6.

[64] B-1172; B-1124.

[65] *See Columbia Cas. Co. v. Playtex FP, Inc.*, 584 A.2d 1214, 1217 (Del. 1991) (determining the preclusive effect of a judgment rendered by a federal district court in Kansas); *Reinhard & Kreinberg v. Dow Chem. Co.*, 2008 WL 868108 (Del. Ch. Mar. 28, 2008).

[66] *See Prusky v. Reliastar Life Ins. Co.*, 502 F. Supp. 2d 422, 428, n.10 (E.D. Pa. 2007) (*citing Semtek Int'l Inc. v. Lockheed Martin Corp.*, 531 U.S. 497, 508-09 (2001); *see also, Curley v. McVey*, 2009 WL 589809, at *5 (W.D. Pa. Mar. 9, 2009) (*citing Witkowski v. Welch*, 173 F.3d 192, 198 (3d Cir. 1999)).

[67] *Greenway Ctr., Inc. v. Essex Ins. Co.*, 475 F.3d 139, 147 (3d Cir. 2007) (*citing Shaffer v. Smith*, 673 A.2d 872, 874 (Pa. 1996)).

All four of the above criteria for collateral estoppel under Pennsylvania law are clearly established by the PA Fraud Opinion.[68] With regard to finality, under Pennsylvania law, PA Fraud Opinion "is deemed final for purposes of *res judicata* or collateral estoppel unless or until it is reversed on appeal."[69] Thus, both the Trial Court and Merritt were (and are) bound by the fraud finding.

3. Merritt's Res Judicata Claim Concerning The Pinhooking Dispute Is Baseless (And Barred).

R&R previously sought the removal of Merritt in a complaint filed in New York state court, based upon conduct by Merritt that was identified in an 2005 Notice of removal ("2005 Notice").[70] The scope of the New York removal claim was (and is) defined by that notice.[71] Indeed, there can be no reasonable dispute over the basis for R&R' removal claim in 2005, because the 2005 Notice speaks for itself.

The 2005 Notice does not mention the pinhooking dispute, or Merritt's fraud related thereto, as a basis for Merritt's removal for "Cause."[72] Although fraud is mentioned in the 2005 Notice, it is identified as fraud related to Merritt's contribution of funds to the LLCs.[73]

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[68] B-1126 - B-1127

[69] *Shaffer,* 673 A.2d 872, 874.

[70] A-256 - A-260. *See also* B-739 - B-741.

[71] *Accord* A-216 (¶ 14) (acknowledging the October 2005 Notice as "the framework" for the New York removal claim).

[72] A-256 - A-260

[73] *Id.* ("Specifically, we are removing you because it is now readily apparent that you, both directly and indirectly through your agent, Len Pelullo, defrauded R&R out of significant sums of money. Just from our accountant's initial review of those shoddily kept books and records that you did make available for inspection it appears that R&R has more than $3 million more in capital invested in the various entities than you do. R&R never agreed to this, and a large portion of

In November 2005, R&R filed suit against Merritt in New York state court, alleging that Merritt and Pelullo defrauded them, and seeking an accounting of the LLCs.[74] The New York complaint sought, among other things, to remove Merritt based upon the conduct identified in the 2005 Notice.[75] In addition, the New York complaint contained fraud allegations relating to the pinhooking dispute; however, the pinhooking dispute was ultimately litigated in the PA Pinhooking Action, not in New York state court.

It is abundantly clear that the pinhooking dispute was never adjudicated in New York. During the New York bench trial on February 26, 2007, Justice Ramos unequivocally stated - and the parties each explicitly confirmed - that the pinhooking dispute was not at issue in New York and was to be considered by the Pennsylvania federal court:

> THE COURT:… At [paragraphs] 147 and 151 [of the Amended Complaint] there is something about Pinhooking-horses.[76] **Maybe, we can agree that those ducks have been taken to another market that is being litigated down in Philadelphia?**
>
> MR. WAGNER [R&R's counsel]: Yes.
>
> MR. FIORAVANTI [Merritt's counsel]: Okay.[77]

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the funds advanced by R&R were done so based on your express representation that you were contributing the same amount of funds at the same time, which obviously did not happen. This alone constitutes fraud under the operating agreements.").

[74] *See, e.g.*, B-1246 - B-1285 (New York Amended Complaint).

[75] Ultimately, on October 6, 2006, Plaintiffs' removal claims based upon the October 2005 Notice were dismissed by Justice Ramos.

[76] The paragraphs referenced by Justice Ramos relating to the pinhooking dispute are contained in first cause of action in the amended complaint, for fraud. B-1274 - B-1277. The seventh cause of action in the amended complaint, related to Merritt's removal as managing member, does not mention the pinhooking dispute.

[77] B-1407 (Feb. 26, 2007 transcript); *see also* B-1212 (June 24, 2009 McLaughlin opinion) (*citing* same).

During that same proceeding, Merritt's counsel made a point of emphasizing that "[t]he Pinhooking-horses matter is in another jurisdiction"[78] – *i.e.* Pennsylvania.

Setting aside the fact that she is wrong, Merritt is precluded from arguing that *res judicata* barred the Trial Court from confirming the validity of Merritt's removal. The NY First Dept has repeatedly held that the Delaware proceedings do not overlap with the 2005 New York proceedings.[79] Moreover, the Trial Court independently concluded that Justice Ramos had not decided R&R's removal claim based on the pinhooking fraud, and noted that the judge in the PA Pinhooking Action "failed to find that Justice Ramos specifically ruled on the pinhooking transaction."[80]

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[78] B-1411 (Feb. 26, 2007 transcript).

[79] *See, e.g.*, B-1121 at ¶ 8 (discussing NY First Dept orders). *See also* B-1231 – B-1239 at ¶¶ 46-67 (rebutting Merritt's arguments).

[80] A-805.

II. THE STATUS QUO RULING WAS NOT AN ABUSE OF DISCRETION (OB 14).

A. Question Presented.

Whether the Trial Court erred by denying Merritt's motion to amend the *status quo* order.

B. Scope of Review.

This Court reviews the decision to enter, deny, enforce, modify or maintain a *status quo* order under an abuse of discretion standard.[81]

C. Merits of Argument.

1. Merritt Misstates The Issue On Appeal.

Merritt misstates the issue on appeal concerning the Status Quo Ruling.[82] The Trial Court did not decide the substantive question of whether Merritt (or any other party) had a valid contractual right to advancement pursuant to Section 9.1 of the LLC Agreements. Rather, Chancellor Chandler simply denied Merritt's motion to modify the existing *status quo* order to permit her to use or sell the LLCs' assets to advance herself attorneys' fees. As such, the Status Quo Ruling is not subject to a *de novo* standard of review.

2. Merritt Abandoned Her Argument That The *Status Quo* Order Should Have A Carve-Out For Advancement.

Although Merritt argues that the Trial Court should have amended the *status quo* order to permit advancement, that argument was waived. During the initial August 28, 2008, telephonic hearing concerning R&R's motion for a *status quo* order, Merritt's counsel argued that the form of order entered (if any) should have a carve out for the

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[81] *See Lawson v. Meconi*, 897 A.2d 740, 743 (Del. 2006); *Hallett v. Carnet Holding Corp.*, 809 A.2d 1159, 1162 n.9 (Del. 2002).

[82] OB 14-17.

"advancement of attorneys' fees" to Merritt.[83] Yet, Merritt's subsequent brief abandoned that argument[84] and, therefore, waived it.[85]

3. The Trial Court Did Not Abuse Its Discretion.

Because Merritt misstates the issue on appeal, the Opening Brief does not assert that the Trial Court abused its discretion.[86] Even if it had, the record clearly establishes that the Status Quo Ruling was the product of an orderly and logical deductive process, and is supported by ample evidence in the record.

By July 10, 2009, (i) a Pennsylvania court had found Merritt guilty of fraud, (ii) R&R had already filed its Summary Judgment Motion explaining why Merritt's August 2008 removal should be confirmed as a matter of law, and (iii) R&R had articulated its position that any contractual advancement right terminated as of August 20, 2008 (the date of Merritt's removal) under the unambiguous terms of the LLC Agreements.[87] The Trial Court recognized that any contractual advancement claim was contingent upon a party's status as manager of the LLCs and, therefore, concluded that it would be imprudent to authorize advancement to anyone (either Merritt or R&R, both of whom claimed to be the valid manager) before determining their status *vis-a-vis* the LLCs.[88] There is nothing arbitrary or capricious

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[83] B-457 - B-458.

[84] *See* B-700 - B-715.

[85] *See In re Estate of Link*, 2011 WL 2084161, at *1 n.1 (Del. Ch. May 5, 2011) (finding that a pro se litigant's failure to raise an exception to the final accounting in briefing constituted a waiver).

[86] *E.g.*, OB 19.

[87] A-201.

[88] A-193. *See also Gary v. Beazer Homes USA, Inc.*, 2008 WL 2510635, at *1 (Del. Ch. June 11, 2008)(similarly refusing to interpret a party's arguable advancement rights under an employment

about the Status Quo Ruling, nor is there any basis to conclude that the Trial Court exceeded the bounds of reason in light of the circumstances as they existed on July 10, 2009.

4. Merritt Received The Benefit Of Her Bargain.

Although she claims "severe prejudice" flowing from the Status Quo Ruling,[89] Merritt received the bargained-for contractual rights contained in the LLC Agreements. Indeed, the parties agreed that advancement would not be available where the [Manager] had been terminated for "cause."[90] As noted in *Gary*, "[t]here is nothing unusually harsh about this contractual outcome."[91] "It only means that ... just like every other party subject to the default American Rule," Merritt had pay her own attorneys' fees in order to vindicate her contractual rights.[92] Had the Trial Court ultimately concluded that Merritt was entitled to advancement, she could have been compensated for the loss of that contractual right.[93] However, ignoring the plain language of Section 4.5 would have irrevocably denied R&R the benefit of its bargain – *i.e.*, "the ability to foreclose [Merritt's] arguable right to advancement by [removing her] for cause."[94] As for Merritt's reliance upon the public policy

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agreement where the agreement terminated with a "for cause" dismissal and whether there were proper grounds for a "for cause" dismissal was at issue in the litigation).

[89] OB 16.

[90] *See* B-173 - B-174. At the risk of stating the obvious, reasonable parties could agree that certain acts of moral turpitude (such as felonies, fraud and embezzlement) justified the immediate termination of rights.

[91] *Gary*, 2008 WL 2510635, at *4.

[92] *Id.*

[93] *See id.*

[94] *Id.* at *1.

underlying corporate advancement, it is misplaced [95] because, in the LLC context, Merritt's rights begin and end with the LLC Agreements.[96] Indeed, the Delaware public policy relevant to this dispute is freedom of contract.[97]

5. Any Error By The Trial Court Was Harmless.

Even if this Court were to conclude that the Status Quo Ruling was erroneous, Merritt suffered no prejudice if this Court confirms summary judgment in the DE Removal Action. A lower court's error is not reversible and is in fact harmless, unless it can be shown that the error resulted in an erroneous outcome.[98] Summary judgment in the DE Removal Action was based on the unambiguous plain language of the LLC Agreements. Interpretation of unambiguous contractual language is a question of law,[99] which this Court reviews *de novo*.[100] In this appeal, Merritt is represented by counsel and the Court is reconsidering the Trial Court's legal conclusions under a *de novo*

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[95] *See* OB 15.

[96] *Gary*, 2008 WL 2510635 at *8.

[97] This Court has characterized the LLC Act as a "flexible statute," which provides parties with substantial freedom to define the terms of their relationship, as long as they do "not contravene any mandatory provisions of the Act." *Elf Atochem N. Am., Inc. v. Jaffari*, 727 A.2d 286, 290 (Del. 1999).

[98] *See In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 63 (Del. 2006)("To say it differently, even if the Chancellor's definition of bad faith were erroneous, the error would not be reversible because the appellants cannot satisfy the very test they urge us to adopt.").

[99] *O'Brien v. Progessive N. Ins. Co.*, 785 A.2d 281, 286 (Del. 2001)

[100] *Reddy*, 945 A.2d 1080, 1085.

standard of review. Accordingly, if this Court finds summary judgment to be appropriate, Merritt suffered no prejudice.[101]

6. Merritt's *Res Judicata* Claim Is Unfounded.

Finally, Merritt argues that the New York court previously determined that she was entitled to advancement and, as such, the doctrine of *res judicata* required the Trial Court to establish a carve-out in the *status quo* order permitting advancement to Merritt.[102] Merritt's argument is unfounded because (i) the LLCs – *i.e.*, the parties against which any advancement claim would be made – were not parties to the New York proceedings, (ii) the January 4, 2008, order identified by Merritt (A572-A579) related to indemnification (not advancement),[103] and (iii) the New York order was entered prior to Merritt's removal as manager, which materially changed Merritt's contractual rights under the LLC Agreements. With regard to point (iii), even if the New York courts had determined in January 2008 that Merritt was entitled to advancement as manager of the LLCs, that

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[101] By referring to herself as "*pro se* litigant," Merritt ignores the fact that she was represented by multiple lawyers in various proceedings.

[102] OB 16 (claiming that "the New York court granted Merritt's request for indemnification **and advancement of legal fees**…").

[103] OB 17 (referring to the "issue in question here" as indemnification, not advancement); A-577 ("Merritt also seeks to dispose of the assets to satisfy **the indemnification obligations** the Entities owe to her."). After the Summary Judgment Opinion, Merritt moved to amend her counterclaims in the New York action to pursue indemnification claims against the LLCs. While the New York Trial court initially permitted the counterclaims to be amended, that decision was overturned by the NY First Dept, which made clear that Merritt's indemnification claims were not at issue in New York Action. B-2214 ("Nor is there a viable counterclaim for indemnification since any indemnification rights [Merritt] had were against the LLCs owned by the parties, and, **therefore, were within the sole jurisdiction of the Delaware Chancery Court**.").

determination would not address whether Merritt was entitled to advancement after her removal as manager in August 2008. Thus, the elements of *res judicata* are not satisfied.

III. THE TRIAL COURT DID NOT ABUSE ITS DISCRETION BY ENTERING THE CONTEMPT ORDER AGAINST MERRITT (OB 27).

A. Question Presented.

Whether the Trial Court abused its discretion by entering the Contempt Order against Merritt and her wholly owned entities (Mer-Lyn Farms, LLC and Merritt Litigation Support, Inc.).

B. Standard of Review.

"A trial judge has broad discretion to impose sanctions for failure to abide by its orders."[104] "The fashioning of a remedy to compel obedience to an injunctive order, such as setting the amount of a fine, is a matter within the sound discretion of the Court."[105] Accordingly, this Court reviews a trial court's imposition of sanctions for failure to comply with its orders for abuse of discretion.[106] "To the extent a decision to impose sanctions is factually based, [this Court will] accept the trial court's factual findings so long as they are sufficiently supported by the record, are the product of an orderly and logical reasoning process, and are not clearly erroneous."[107] "Moreover, where factual findings are based on determinations regarding the credibility of witnesses ... the deference already required by the clearly erroneous standard of appellate review is enhanced."[108]

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[104] *Gallagher v. Long*, 2007 WL 3262150, at *2 (Del. Nov. 6, 2007) (TABLE).

[105] *Wilmington Federation of Teachers v. Howell*, 374 A.2d 832, 838 (Del. 1977).

[106] *Gallagher*, 2007 WL 3262150, at *2.

[107] *Genger v. TR Investors, LLC*, 26 A.3d 180, 190 (Del. 2011).

[108] *Id.* (internal quotations omitted).

C. Merits of Argument.

1. Merritt Violated Multiple Trial Court Orders.

The Trial Court's June 28, 2010 Contempt Order found Merritt in contempt of multiple Court orders for, among other things, (i) failing to vacate the Farm and affirmatively resisting the Receiver's efforts to evict her from the Farm, (ii) causing two wholly owned entities to file mechanics liens against properties owned by the LLCs in an attempt to frustrate the sale of those properties, and (iii) failing to remedy her contemptuous behavior after being afforded the opportunity to do so after the Contempt Hearing.[109]

The Opening Brief does not deny that Merritt engaged in the underlying conduct at issue in the Contempt Order. Instead, it attempts to justify Merritt's actions by claiming that the Receiver acted imprudently, and that Merritt's conduct was somehow consistent with, or in furtherance of, New York court orders.[110] Moreover, the Opening Brief incorrectly asserts that Merritt was found in contempt for "merely ... pursuing her rights in the first-filed New York action."[111] Despite Merritt's efforts to engage in revisionist history, the record speaks for itself. The Contempt Order was the product of an orderly and logical reasoning process, and was not clearly erroneous. Therefore, the Contempt Order should be affirmed.

2. The Record Supports The Contempt Order.

The Receiver's June 21, 2010, motion for contempt ("Contempt Motion") and the Contempt Hearing transcript detail Merritt's

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[109] A-965.
[110] OB 25, 27-34.
[111] OB 32.

contemptuous behavior and her efforts to frustrate the Receivership.[112] While those documents are incorporated herein by reference, Merritt's contemptuous behavior is briefly described below.

With regard to the Farm, Merritt:

- refused to vacate the Farm in violation of a February 25, 2010, injunction issued by the Trial Court.[113]
- opposed the Receiver's eviction and ejectment proceedings in Pennsylvania.[114]

The above conduct was problematic because Merritt's removal from the Farm was necessary to wind up the LLCs (*e.g.*, to sell the Farm lease).[115] Yet, Merritt freely admitted that her wholly owned entity continued to occupy the Farm as of the Contempt Hearing.[116]

With regard to winding-up, the Trial Court entered the Implementing Order on September 14, 2009,[117] and an order establishing the framework for the Receivership on November 9, 2009.[118] Among other things, the foregoing Court orders obligated Merritt to submit her claims concerning the LLCs exclusively to the Receiver and/or the Trial Court. Nevertheless, Merritt:

- caused her wholly owned entities to file mechanics' liens against three of the properties held by the LLCs, thwarting the Receiver's ability to dispose of these assets.[119]

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[112] B-2140 - B-2154 (Contempt Motion).

[113] B-2143 (Contempt Motion) at ¶¶ 8-9; B-2114 - B-2115 (injunction).

[114] B-2144 (Contempt Motion) at ¶¶ 10-11.

[115] B-2184.

[116] B-2165 - B-2166.

[117] Merritt promptly breached the implementing Order, which the Trial Court found unsurprising. B-2141 (Contempt Motion) at ¶ 2; B-2049 - B-2053 (R&R contempt motion).

[118] B-2141 - B-2142 (Contempt Motion) at ¶ 3; B-2104 - B-2109 (Nov. 9, 2009 Order).

[119] B-2145 (Contempt Motion) at ¶ 14.

- caused one of her wholly owned entities (Mer-Lyn Farms, LLC) to file a bad faith bankruptcy in the Eastern District of Pennsylvania in order to take advantage of the automatic stay (which applied to prevent the Receiver from seeking to dismiss the mechanics' liens and to stay the Receiver's Pennsylvania eviction and ejectment proceedings).[120]

- pursued relief related to the DE Removal Action in the New York action.[121]

Having concluded that Merritt was in contempt of court, the Trial Court nevertheless afforded Merritt an opportunity to remedy her violations and avoid the sanction imposed by the Contempt Order. As Chancellor Chandler explained to Merritt during the Contempt Hearing:

> I'm going to sign the order finding you in contempt for obstruction of earlier orders of this Court, which required you to cooperate in assisting the receiver in liquidating and selling these assets, because I find, based on all the evidence available to me, that you have at every turn attempted to in fact obstruct, delay, and flout the orders of this Court. So I'm going to enter that order.
>
> But because I still have respect for you as a litigant, I will do this. I will not sign this order until noon on Monday. At noon, on Monday, I will enter this order. However, if before noon on Monday the receiver calls me and tells me that you have fully complied and cooperated, you've removed everything from the property that you were required to remove, if you do all of that before noon on Monday and the receiver calls me and leaves word with me that you have cooperated and now he can go forward with a sale of the property, or of the lease on these properties, then I won't enter the order, Merritt.
>
> So it's entirely up to you. It is of your choosing. You've already told me you are the sole member and manager of Mer-Lyn [Farms, LLC]. You can effect the very things that Mr. Heyman, as the receiver, has asked you to effect, to make it

[120] B-2146 - B-2147 (Contempt Motion) at ¶ 17; B-1112 - B-1116 (attaching July 9, 2010 Order dismissing the bankruptcy petition due to the *"Debtor's lack of good faith in filing the petition"*).

[121] B-2147 (Contempt Motion) at ¶ 19.

> possible for him to move forward with the final steps of this receivership. And if you will do that before noon on Monday and he advises me of that, I won't enter the order.
>
> But to repeat: if I don't have that word by noon on Monday, I'm entering the order of contempt.[122]

Despite being afforded an opportunity to cure, Merritt chose to persist in her contemptuous behavior.

3. The Trial Court Properly Found Merritt In Contempt.

"The inherent contempt power of the Delaware courts and the breadth of its scope are well established."[123] Indeed, this Court has previously recognized that this inherent power "is essential to the administration of justice."[124] "Contempt sanctions may be imposed in an ordinary civil proceeding upon notice and an opportunity to be heard."[125]

The record establishes that not only did Merritt have the opportunity to respond to the Receiver's Contempt Motion (both in briefing and at the Contempt Hearing), but the Trial Court also gave her almost 72 hours to bring herself into compliance before finding

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[122] B-2200 - B-2201.

[123] *DiSabatino v. Salicete*, 671 A.2d 1344, 1348 (Del. 1996).

[124] *Id.* (quoting *Young v. US ex rel., Vuitt on et Fils S.A.*, 481 U.S. 787, 795 (1987)).

[125] *Id.* at 1349. (internal quotations omitted) Although Merritt cites to Court of Chancery Rule 70(b), this rule speaks directly to a trial court's power to order an attachment for "failure to obey or to perform any order." *See* Ct. Ch. R. 70(b). The Trial Court, however, did not order an attachment in this case. Moreover, nothing in Rule 70(b) states that is limits the Trial Court's was relying on its inherent contempt authority. Nevertheless, the Contempt Motion was based upon (i) documentary evidence, (ii) oral and written representations by the court-appointed Receiver (which were subject to Rule 11), (iii) oral and written representations by Merritt (which were subject to Rule 11). Moreover, Merritt directly answered the Trial Court's questions during the contempt hearing. As such, any suggestion that the Trial Court lacked an adequate record is baseless.

her in contempt. At the Contempt Hearing, Merritt demonstrated that she understood the Trial Court's orders, and there was nothing ambiguous about the Trial Court's directive to Merritt during the Contempt Hearing - Merritt simply chose to ignore that directive after being advised of the consequences flowing from her continued contempt.[126]

4. The Contempt Order Was Appropriately Tailored.

"The remedy of civil contempt serves two purposes: to coerce compliance with the order being violated, and to remedy injury suffered by other parties as a result of the contumacious behavior."[127] A court has broad discretion to impose sanctions for failure to abide by its orders, but in selecting the appropriate sanction a court should "use the least possible power adequate to the end proposed."[128] Delaware law, however, requires simply that a sanction for contempt be "just and reasonable."[129]

By July 2010, it was clear that the Trial Court had few options available to coerce Merritt.[130] At the Contempt Hearing, R&R explained the context and argued that the Contempt Order sanction was the only viable leverage left to coerce Merritt's compliance:

> [O]ur primary concern at this point is the fact that the receiver is dissipating assets because he has to fight with Merritt. Hundreds of

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[126] *Accord Aveta Inc. v. Bengoa*, 986 A.2d 1166, 1181 (Del. Ch. Dec. 24, 2009) ("To be held in contempt, a party must be bound by an order, have notice of it, and nevertheless violate it.").

[127] *Bengoa*, 986 A.2d at 1181.

[128] *Id.* at 1188.

[129] *Gallagher*, 2007 WL 3262150, at *2.

[130] *Bengoa*, 986 A.2d at 1181 (finding that simply reiterating the previous orders was insufficient).

> thousands of dollars have been spent trying to force her to comply with Your Honor's orders.
>
> [Merritt] has no money. She is bankrupt. There will ultimately never be a recovery from her. There are more member claims to the[LLCs] than there are assets left. And the fear at this point is, if we keep down this path and have to fight [Merritt], we're going to be left with nothing. And it won't harm Merritt because she already has nothing. It will harm our clients…
>
> [O]ne of the concerns Your Honor started to raise was, why the component of the contempt order that says no claims [by Merritt against the LLCs]? It's the only leverage left with this individual. She has no money, she has her freedom, and she has whatever potential recovery she can receive from the[LLCs]. Without touching the freedom question, Your Honor can press leverage on her with respect to whether or not she's ever going to get anything from the[LLCs], to the extent even her claims are valid….[131]

Left with the options of jail time or depriving Merritt of a potential recovery from the LLCs, the Trial Court chose the less extreme form of leverage. Merritt was not coerced. The fact that Merritt failed to remedy the violations when afforded an opportunity to do so after the Contempt Hearing further justifies the Contempt Order.[132]

Moreover, the contempt sanction imposed against Merritt was tantamount to entering judgment in R&R's favor in the Receivership action. It is well established that where a party has willfully or consciously disregarded the Court's orders, the entry of judgment against that party is a permissible sanction.[133]

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[131] B-2191 - B-2193. As noted elsewhere, R&R contends that Merritt was not entitled to any recovery from the LLCs.

[132] *See Gallagher*, 2007 WL 3262150, at *2 (where there is "an element of willfulness or conscious disregard of a court order," entry of judgment may be appropriate).

[133] *Bengoa*, 986 A.2d at 1190; *see also Gallagher*, 2007 WL 3262150, at *2.

5. The Contempt Order Was Not "Grossly Excessive."

Citing *Quinter v. Volkswagen of America*,[134] ostensibly for the proposition that sanctions may not exceed the actual damages caused by the contempt, Merritt ignores the intended (although ultimately unsuccessful) coercive effect of Chancellor Chandler's contempt finding. As the United States Supreme Court case cited in *Quinter* indicates, the limitation only applies where the sanctions imposed are solely compensatory.[135] In this case, the sanction threatened (and ultimately imposed) by Chancellor Chandler was primarily coercive, expressly conditioned on Merritt's continued noncompliance.[136]

But even ignoring the coercive intent of the contempt sanction, Merritt's estimate of the monetary value of her sanction, which she summarily asserts exceeds $15 million, finds no evidentiary support in the record (and should be given no weight).[137] Merritt's assertion is

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[134] 676 F.2d 969 (3d Cir. 1982).

[135] *United States v. United Mine Workers of America*, 330 U.S. 258, 303-04 (1947) ("Judicial sanctions in civil contempt proceedings may, in a proper case, be employed for either or both of two purposes; to coerce the defendant into compliance with the court's order, and to compensate the complainant for losses sustained. Where compensation is intended, a fine is imposed, payable to the complainant. Such fine must of course be based upon evidence of complainant's actual loss, and his right, as a civil litigant, to the compensatory fine is dependent upon the outcome of the basic controversy. But where the purpose is to make the defendant comply, the court's discretion is otherwise exercised.") (citations and footnotes omitted).

[136] *See id.* at 305 (noting that a higher sanction may have been appropriate if part of the fine was conditioned on the party's failure to purge itself within a reasonable time).

[137] OB 27-28. Merritt also mistakenly equates the costs the Receiver expended in litigating her objections to the Receivership (approximately $150,000) with the damage suffered by R&R as a result of her contempt. OB 28. R&R's own litigation expenses (both here and in New York), the costs of Merritt's continued possession of the Farm and the Receiver's increased costs associated with her attempts to stall the Receivership all flow directly from Merritt's contempt.

contrary to the finding of the Court-appointed forensic accountant who was unable to corroborate any of Merritt's alleged contributions to the LLCs.[138] The foregoing conclusion is noteworthy because Merritt was compelled by the Trial Court to produce all relevant documents and information.[139] Therefore, Merritt cannot equitably claim that she possesses supporting evidence that is not contained in the record below. Even if Merritt had such evidence, her failure to produce that evidence in the proceedings below constitutes yet another violation of the Trial Court's orders.

6. The Contempt Order Is Consistent With Rule 65(d).

The Opening Brief argues that the Contempt Order violated due process because Merritt's wholly owned entities are not parties to the Delaware Removal Action. Yet, as Chancellor Chandler noted, the technical distinction between Merritt and her wholly owned entities is of no consequence.[140] Pursuant to Court of Chancery Rule 65(d), the Trial Court's injunction is binding upon Merritt's entities.[141] The Opening Brief makes no effort to explain why Court of Chancery Rule 65(d) does not apply.

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[138] B-2260 (Independent Accounting) (stating Merritt's member contributions were $0, R&R's member contributions were $7,422,445, and R&R's capital bridge loans were $833,552).

[139] *See* A-1141 - A-1142; B-1091 (granting motion to compel production of documents including request that Merritt product documents sufficient to show her capital contributions to the LLCs).

[140] B-2173 (noting "[T]hey're all under your control and direction because you're the sole member of Mer-Lyn Farms. So you can order them to leave; right?"); *accord Fulk v. Wash. Serv. Assocs., Inc.*, 2002 WL 1402273, at *11 (Del. Ch. June 21, 2002)(finding that pursuant to Rule 65(d) nonparties to an injunction proceeding could by bound by the injunction).

[141] Ct. Ch. R. 65(d); *see also* B-2160 (arguing below that Ct. Ch. R. 65(d) made the Court's prior orders binding on Mer-Lyn Farms, LLC).

IV. MERRITT'S CLAIMS CONCERNING CHANCELLOR CHANDLER DO NOT UNDERMINE THE TRIAL COURT'S ORDERS (OB 40).

A. Question Presented.

Whether Chancellor Chandler was required to recuse himself based on either Merritt's perceived bias or an appearance of impropriety.

B. Standard of Review.

Generally, a trial court is required to make two findings on the record when confronted with an issue of bias or impropriety.[142] Once the judge has subjectively determined that no bias exists, the judge must then objectively determine whether (actual bias aside) there is an appearance of bias sufficient to cause doubt about the judge's impartiality.[143] Recusal is appropriate where an objective observer would conclude that a fair and impartial hearing is unlikely.[144] This Court reviews a trial judge's subjective analysis for abuse of discretion and reviews the objective analysis *de novo*.[145] Where the issue was not presented below, this Court has focused on the objective element of this analysis.[146]

C. Merits of Argument.

This is not the first time that Merritt has attempted to have Chancellor Chandler removed from this case based on an unsubstantiated accusation of bias.[147] Here, as before, Merritt has produced no

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[142] *Fritzinger v. State*, 10 A.3d 603, 611 (Del. 2010).

[143] *Id.*

[144] *Ebersole v. Evans Builders*, 2011 WL 379409, at *2 (Del. Feb. 7, 2011) (TABLE).

[145] *Fritzinger*, 10 A.3d at 611.

[146] *Ebersole*, 2011 WL 379409, at *2.

[147] *See, e.g.*, A-1184 - A-1185 ("Right now, Ms. Merritt, I want you to concentrate, because you made an accusation in writing that Mr. Rollo and Mr. Sweeney, who are sitting right there in this Court, and me had some ex parte conversation or correspondence involving this

evidence of impropriety.[148] There is no evidence of any "longstanding allianc[e]" between Wilson Sonsini, the Receiver, Chancellor Chandler, and/or Richards, Layton & Finger.[149] Nor is there any evidence that Chancellor Chandler had any professional relationship with Wilson Sonsini (other than the law firm having previously appeared before him) in February 2011 (when he rendered final judgment in this Action) or at any prior time.[150] Accordingly, this Court's decision in *Ebersole* is inapposite.[151]

Merritt's allegations of an *ex parte* communication between Chancellor Chandler and the Receiver on October 6, 2010 are without merit. As the Chancellor explained to Merritt at the final hearing this Action, the Receiver was functioning as a neutral officer of the Court and, as such, there could be no *ex parte* communications.[152] The record indicates that the conversation at issue related solely to an

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case that you are not aware of. And I want you to produce whatever evidence you have to support that accusation, and I want you to produce it now.").

[148] A-1183 - A-1191.

[149] *See* OB 31. The cases cited by Merritt, in which Wilson Sonsini has worked with either Richards, Layton & Finger or Proctor Heyman suggest nothing more then a typical professional relationship between forwarding and local counsel in this jurisdiction.

[150] *See* OB 30-31.

[151] *See Ebersole*, 2011 WL 379409, at *2 (finding that where "between the time of the hearing and the decision, the hearing officer [who participated in the hearing but did not render the final judgment] interviewed with and began working for the law firm that represented the [defendant] in [the] case, the hearing officer should have recused herself").

[152] A-1228 ("Now, with respect to Mr. Heyman, that is a different matter. You allege that I have communicated with Mr. Heyman in an ex parte way, and that that is improper under the rules. Well, let's clear the air on this, because on October the 6th, or thereabouts, I did make a telephone call to Mr. Heyman. He didn't call me. I called him. That is because he is the court-appointed receiver. He works for me. He doesn't work for you. He doesn't work for R&R Capital. He works for me.").

administrative matter regarding the Receivership.[153] But even if there were more to the conversation, the Receiver was not a party to this Action.[154] The Receiver was an agent of the Trial Court, and communications between the Trial Court and its agent are not *ex parte* communications.[155]

As discussed above, the Trial Court's decisions in this case were grounded in well-established Delaware law. They do not in and of themselves suggest any impropriety, and Merritt has not pointed to any specific ruling of the Trial Court that suggests an objective appearance of bias. Throughout, Chancellor Chandler treated Merritt with the respect due to all litigants coming before Delaware courts, and his handling of the DE Removal Action does nothing to impair the integrity of the judicial system.

CONCLUSION

For the reasons above, Merritt's appeal should be denied and the Trial Court's orders at issue in this appeal should be affirmed.

OF COUNSEL:

Paul Sweeney
Certilman Balin, Adler & Hyman, LLP
90 Merrick Ave
East Meadow, NY 11554
(516) 296-7000

/s/ Richard P. Rollo (No. 3994)
Richard P. Rollo (#3994)
Nicole C. Bright (#5311)
Richards, Layton & Finger, P.A.
920 North King Street
Wilmington, DE 19801
(302) 651-7700
Attorneys for Appellees

Dated: June 21, 2012

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[153] A-1228 - A-1231.

[154] A-1230 - A-1231 ("It wasn't substantive about the merits of this case. But it wouldn't matter even if it was, because Mr. Heyman isn't a party. He is the independent receiver. He answers to me.").

[155] *See In re N. European Oil Corp.*, 129 A.2d 259, 261 (Del. Ch. 1957) ("a receiver is but an agent of the Court"); *see also Carrigan v. State*, 2007 WL 3378657, at *3 (Del. Super. 2007) (holding that the court's communication with an officer of the court was not *ex parte*).