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Case Number 144,2011D

THE STATE OF

# 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.

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R&R CAPITAL, LLC and FTP CAPITAL,

LLC,

Plaintiffs below/Appellees,

:

and

.

BUCK & DOE RUN VALLEY FARMS, LLC,:

et al.,

Nominal Defendants below/

Appellees

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

Filing Date: May 20, 2013 Erik C. Grandell, Esquire

Delaware Supreme Court #2708

1473 Spruce Avenue Wilmington, DE 19805

 $(302)\ 757-6627$ 

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R&R's brief rests on two erroneous arguments: (1) the Chancery Court properly construed this Court's remand order as limiting the scope of remand to review of the July 2009 deferral order; and (2) the Chancery Court properly deferred advancement in July 2009 simply because Merritt labeled her request as a motion to "modify the status quo" instead of a motion "for advancement". Neither of these formalistic arguments defeats Merritt's right to advancement. Oral argument is warranted to address the advancement issues raised in this appeal.

The Chancery Court should have reviewed all three deferrals of advancement on remand. Merritt requested advancement multiple times – August 2008, February 2009, and July 2009 -- only to have Chancellor Chandler defer advancement each time. R&R attempts to dodge the first two deferrals by claiming that this Court's remand order limited the Chancery Court's scope of review to the July 2009 deferral.

Limiting remand to the July 2009 deferral is precisely what the Chancery Court should *not* have done. Since the July 2009

 $<sup>^{1}</sup>$  Trans. ID 21278987; Trans ID 24155154, p. 24 (2/25/09); Trans ID 26354286 (7/10/09).

deferral was the third of three deferrals, the Chancery Court should have analyzed the first two deferrals before the third deferral. It was only necessary to review the third deferral if both of the first two deferrals were proper. If either of the first two deferrals was improper, the Court should have granted advancement without examining the third deferral.

Had the Court used the proper procedure on remand by reviewing the first two deferrals, Merritt would have qualified for advancement, for there is no justification for the first two deferrals. The first deferral order (September 8, 2008)<sup>2</sup> gave no explanation at all for denying advancement, even though the plain language of the operating agreements required the Entities to advance Merritt's legal expenses. The second order (February 25, 2009)<sup>3</sup> purported to defer advancement because it was "substantive" matter. Under the operating agreements, advancement does not depend on whether it is "substantive" or "procedural". The only prerequisite for advancement is the

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<sup>&</sup>lt;sup>2</sup> Trans. ID 21278987.

<sup>&</sup>lt;sup>3</sup> Trans. ID 24155154, p. 24.

initiation of legal proceedings against Merritt<sup>4</sup>. Since R&R initiated legal proceedings against her, the operating agreements required the Entities to advance her legal expenses.

And even if it was necessary to review the third deferral decision, Merritt was still entitled to advancement. Chancellor Glasscock suggested that Chancellor Chandler properly denied advancement based on an April 2009 decision against Merritt in Pennsylvania federal court. The April 2009 decision, however, did not exist at the time of the September 2008 and February 2009 deferrals – so Chancellor Glasscock's reliance on the April 2009 decision underscores the absence of any foundation for the two earlier deferrals. Moreover, Chancellor Glasscock suggested that deferral was proper because Merritt was destined to lose on the merits. This contradicts well-settled Delaware law that advancement of legal fees does not depend on the ultimate success

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<sup>&</sup>lt;sup>4</sup> Senior Tour Players 207 Mgmt. Co. v. Golftown 207 Hldg. Co., 853 A.2d 124, 128 (Del. Ch. 2004) ("the right to advancement is not ordinarily dependent upon a determination that the party in question will ultimately be entitled to be indemnified"); see also Appx. 17-18 (section 9.1 of operating agreements).

or failure of the underlying claim against the party seeking advancement<sup>5</sup>.

R&R cannot prevail by relabeling Merritt's request as a motion to "modify the status quo". Merritt repeatedly requested advancement of attorney fees and invoked § 9.1 of the operating agreements in support of this request. The subject matter of § 9.1 is advancement of legal expenses – nothing more.

The Chancery Court appears to concede that § 9.1 requires advancement, yet it attempts to maneuver around § 9.1 by recasting Merritt's request for attorney fees as a motion to modify the status quo and then examining Merritt's request under "status quo" standards. R&R follows the Chancery Court's lead by reciting every reference to "status quo" in the record it can find.

The Chancery Court and R&R have reduced this lawsuit to some type of bizarre game in which Merritt must "say the magic word" in the title of her motion ("advancement") in order to obtain

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<sup>&</sup>lt;sup>5</sup> Morgan v. Grace, 2003 WL 22461916, \*2, \*8 and n.13 (Del. Ch. 2003) (it would be "fallacious" to deny. . . advancement on the ground that [officers] would not be indemnified if the conduct alleged were eventually proved true", because this would "blur[] the distinct purpose of advancement provisions")

relief under § 9.1. This is a legal proceeding with immense reallife consequences for Merritt. Permitting the outcome to turn upon formalistic sleight-of-hand would be an injustice to Merritt and a perversion of well-settled advancement principles. It will also encourage other corporations to circumvent their advancement duties by moving for a "status quo" order to force employees to meet the more onerous standards for modifying the status quo instead of more lenient advancement standards.

In Ridder v. CityFed Financial Corp., 47 F.3d 85 (3d Cir. 1995), the Third Circuit rejected reasoning similar to the Chancery Court's analysis in the present case. There, a bank sued several former employees for fraud, and the employees demanded advancement of their attorney fees in accordance with a provision in the bank's by-laws. The bank refused, and the employees moved for a preliminary injunction to obtain advancement.

The district court concluded that the employees failed to demonstrate a likelihood of success on the merits and that awarding a preliminary injunction would unfairly prioritize the employees' claim over the claims of other creditors. *Id.*, 47 F.3d at 87. The Third Circuit reversed, reasoning:

The issue before the district court was not whether appellants were likely to prevail in the RTC litigation, but whether they were likely to prevail in their assertion that CityFed should advance the costs of defense. Under Delaware law, appellants' right to receive the costs of defense in advance does not depend upon the merits of the claims asserted against them, and is separate and distinct from any right of indemnification they may later be able to establish. . . . Appellants made a strong showing that, unless defense costs were advanced to them, their ability to defend the RTC action would be irreparably harmed. Appellee made no contrary showing, and the district court did not base its holding upon the absence of irreparable harm, but rather upon a comparison between the harm to appellants and the perceived harm to other creditors of CityFed. Here again, however, we conclude that the district court addressed the wrong issue. The only issue before the district court was whether appellants were entitled to advance payment of the cost of defense of the RTC action. The insolvency proceeding itself was not before the district court, and the impact, if any, of a grant of injunctive relief was not only a matter for other tribunals to decide, but, on this record, purely speculative.

#### Id., 47 F.3d at 87-88.

Like the district court in *Ridder*, the Chancery Court neglected to address the central issue of advancement by focusing on the wrong issues. The Chancery Court avoided deciding the merits of Merritt's requests for advancement by labeling them as

requests to "modify the status quo" and applying irrelevant "status quo" principles. It then examined the wrong issue by suggesting that Merritt was unlikely to prevail in R&R's removal action<sup>6</sup>, the same error that the district court made in *Ridder*.

The beginning, middle and end of the Chancery Court's inquiry should have been whether § 9.1 of the operating agreements entitled Merritt to advancement of legal expenses. Merritt respectfully requests that the Supreme Court vacate Chancellor Chandler's orders in their entirety<sup>7</sup> and rule in Merritt's favor on the issue of advancement.

Dated: May 20, 2013

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<sup>&</sup>lt;sup>6</sup> R&R Capital, LLC v. Merritt ("Merritt"), slip. op., pp. 24-25 (Del. Ch., 3/15/13).

<sup>&</sup>lt;sup>7</sup> Chancellor Chandler abused his discretion by removing Merritt as Managing Member of the Entities without evidentiary hearings or affidavits, finding Merritt in contempt, stripping her of her 50% member interest in the Entities and voiding over \$10,000,000 of capital, loans and receivables owed to Merritt and her wholly owned companies (her entire life savings).

#### **Certification of Service**

I hereby certify that on May 20, 2013, true and correct copies of the foregoing were caused to be served by Lexis/Nexis E-Service upon:

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