IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

ANGLO AMERICAN SECURITY FUND, L.P., DIVERSIFIED LONG TERM GROWTH FUND, L.P., STERLING GRACE CAPITAL MANAGEMENT, L.P., DRAKE ASSOCIATES, L.P., THE LORRAINE G. GRACE TRUST 1487 and OLIVER R. GRACE JUNIOR TRUST 90 II,	)	
Plaintiffs,	)	
v.	)	Civil Action No. 20066-N
S.R. GLOBAL INTERNATIONAL FUND, L.P., SLOANE ROBINSON INVESTMENT (CAYMAN), LTD., and ERNST & YOUNG LLP,	)	
Defendants.	)	

MEMORANDUM OPINION

Date Submitted: April 18, 2006
Date Decided: May 24, 2006

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CHANDLER, Chancellor

Plaintiffs, a group of trusts and partnerships jointly controlled by, or operating for the benefit of, John and Oliver Grace (collectively, the "Graces"), separately contributed amounts totaling approximately $27 million dollars to defendant S.R. Global International Fund, L.P. (the "Fund"). The Fund's general partner was defendant Sloan Robinson Investment (Cayman) Ltd. (the "GP" and, together with the Fund, the "SR Defendants"). Plaintiffs and the GP were parties to the Limited Partnership Agreement (the "LPA") governing the Fund. The present dispute arises from the interpretation of the LPA and certain alleged duties existing between limited and general partners in the context of events that occurred primarily between December 1999 and May 2000.

I. FACTUAL BACKGROUND

The Fund is a Delaware limited partnership formed in 1997 with the objective of providing "investors with capital appreciation principally through investments in a diversified selection of exchange-traded equity securities from any country, foreign exchange contracts, exchange-traded equity indices and exchange-traded futures and options on any of the foregoing."[1] In other words, the Fund was a hedge fund. The GP is a Cayman Islands company that engaged International Fund Services (Ireland) ("IFS") to administer the Fund. The GP also

[1] SR Defendants' Opening Brief in Support of Their Motion for Summary Judgment ("DOB"), Ex. O at 1.

engaged Sloane Robinson Investment Management ("SRIM") to act as the Fund's investment advisor.

The LPA provided that each partner has a "Capital Account" on "the books and records of the [Fund]."[2] The incentive fee, approximately 15% of each limited partner's net profits, is debited from each limited partner's Capital Account and credited to the GP's Capital Account as of the end of the fiscal year.[3] The GP has the right to withdraw funds from its Capital Account as of the last day of any month.[4] Finally, the books of account and records of the Fund are audited as of the end of the fiscal year.[5] The Fund's independent certified accountants prepare audited financial statements that the Fund provides to the limited partners promptly after the end of each fiscal year.[6]

Defendant Ernst and Young ("E&Y") is a Delaware limited liability partnership that served as the Fund's independent certified accountants from 1997 through 2001. Each year, E&Y prepared the Fund's audited financial statements from the books and records of the Fund provided by IFS.[7]

In 1999 the Fund had a banner year, earning a net income of $194,847,072. For such performance, the GP earned an incentive fee of $22,350,704 for the year. The evidence is clear that the incentive fee was withdrawn from the limited

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[2] DOB Ex. AA (the "LPA"), § 8.01.
[3] *Id.*, at § 9.01(b).
[4] *Id.*, at § 5.02(b).
[5] *Id.*, at § 12.02.
[6] *Id.*, at § 12.05.
[7] DOB Ex. G at 58; DOB Ex. F at 30-31.

partners' Capital Accounts as of the end of the fiscal year on December 31, 1999 and credited to the GP's Capital Account (for lack of a better term, the "Allocation").[8] The incentive fee was then withdrawn from the GP's Capital Account and credited to an accounts payable account after the close of business on December 31, 1999 (the "Withdrawal"), and was eventually disbursed as cash to the GP on February 18, 2000 (the "Disbursement"). The record also is quite clear that the incentive fee was no longer invested as capital after December 31, 1999 and was withdrawn from the GP's Capital Account sometime on December 31, 1999. Plaintiffs' expert concedes that in his review of the record nothing suggested that the GP continued to have the incentive fee invested as capital after December 31, 1999,[9] and that he believed that the GP withdrew its incentive fee "[a]s of the end of December 31st, '99, yes."[10] E&Y's expert likewise testified that the GP withdrew its incentive fee as of December 31, 1999.[11] Thus, there is no dispute on this record that the incentive fee was no longer invested as capital after December 31, 1999, and that the incentive fee was withdrawn as of December 31, 1999.

The Allocation to the GP's Capital Account was reported to the limited partners in February in the Fund's 1999 fourth quarter statement,[12] received by the

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[8] Plaintiffs' Opening Brief in Support of Their Motion for Summary Judgment ("POB"), at 10; S.R. Defendants' Reply Brief in Support of Their Motion for Summary Judgment and Answering Brief in Opposition to Plaintiffs' Motion for Summary Judgment ("SRRB"), at 7.
[9] Deposition of Skomorowsky at 92 (hereinafter all citations to depositions will be in the form of "[deponent's surname] [page]").
[10] *Id.*, at 73.
[11] Barry 93-94.
[12] POB Ex. CC.

Graces on February 11, 2000,[13] and again in March in the Audited Financial Statements for the Fund's year ended December 31, 1999 (the "1999 Financials").[14] Though it occurred as of the end of the same calendar day as the Allocation (December 31, 1999), the Withdrawal from the GP's Capital Account was not reported in either the 1999 Fourth Quarterly Statement or the 1999 Financials.

Based on the Fund's 1999 fourth quarter statement received in February, Peter Metz, the CFO of a Grace entity, calculated that the Fund had suffered a 15% loss and recommended that John Grace withdraw from the Fund.[15] John Grace decided to withdraw the one Grace entity that he controlled from the Fund in mid-to-late February;[16] he did so without regard to whether or not the GP kept its special allocation fee for 1999 in the capital of the Fund.[17] John Grace approached his brother Oliver to obtain his consent to withdraw the rest of the plaintiffs from the Fund (such Grace entities were jointly controlled by John and Oliver), but Oliver, without giving a reason, refused to do so and John let the matter drop.[18]

The Withdrawal was disclosed to plaintiffs on May 5, 2000, in the Fund's 2000 first quarter statement. In response to the disclosure of the Withdrawal,

[13] Grace Ex. 24.
[14] POB Ex. R.
[15] Metz 25-27 ("I told [John Grace] that this investment was a very large investment amongst various Grace-related entities. From a risk point of view, we should cut back our exposure in the single investment and that it was volatile").
[16] *Id*., at 38.
[17] John Grace 248-49.
[18] John Grace 131, 243-44, 248-50; Oliver Grace 30-33; Metz 36.

plaintiffs continued to remain invested in the Funds. Not until sixteen months later, in July of 2001, did the Graces redeem their remaining investments in the Fund.

II. STANDARD OF REVIEW

Because the matter is before the Court on cross motions for summary judgment, I apply the well-settled standards for such motions in analyzing the parties' contentions. To prevail, each moving party must show that there is "no genuine issue as to any material fact" and that they are "entitled to judgment as a matter of law."[19] In examining the record, I must draw every reasonable inference in favor of the non-moving party,[20] and accept the non-moving party's version of any disputed facts.[21] That the parties have filed cross motions for summary judgment does not alter this standard.[22]

III. ANALYSIS

A. Count I: Breach of Contract

Plaintiffs allege that the SR Defendants breached the LPA in three alternative manners: by never allocating the incentive fee to the GP's Capital Account, by withdrawing the incentive fee from the GP's Capital Account on a day other than

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[19] CT. CH. R. 56(c).
[20] *See Acro Extrusion Corp. v. Cunningham*, 810 A.2d 345, 347 (Del. 2002).
[21] *Merrill v. Crothall-American, Inc.*, 606 A.2d 96, 99-100 (Del. 1992).
[22] *See Chambers v. Genesee & Wyoming Inc.*, 2005 WL 2000765, at *5 (Del. Ch., 2005) ("Because both sides have alleged that there are outstanding issues of fact material to the resolution of the other's motion, Rule 56(h) does not apply by its own terms.")

the last day of a month, or by not disclosing the December 31 Withdrawal.[23] Upon reviewing the terms of the LPA, and the testimony of both plaintiffs' and defendants' experts, it is evident that the LPA was not breached. "To state a claim for breach of contract under Delaware law, a Plaintiff must establish that a contract existed, that the defendant breached an obligation imposed by the contract, and that the breach resulted in damage to the Plaintiff."[24] In discerning the obligations imposed by a contract at the summary judgment stage, a court should initially focus solely on the language of the contract itself. If that language is unambiguous, its plain meaning alone dictates the outcome.[25]

Plaintiffs' first two allegations of breach of contract misunderstand the facts of the case, while the third allegation misreads the obligations imposed by the LPA. Plaintiffs first allege that the incentive fee was never allocated to the GP's Capital Account, as required by § 9.01(b) of the LPA, but rather was credited directly as an expense. Second, plaintiffs allege that even if the Allocation did take

[23] Plaintiffs attempt to inject yet another claim under the rubric of Count I by asserting that George Robinson orally represented that his money would remain invested alongside the Graces, thereby inducing the Graces to invest in the Fund. POB at 6-7. I reject this eleventh hour claim for two reasons. First, it is not pled in the amended complaint, and parties are not entitled to amend claims in briefing on motions. *See Cal. Pub. Employees' Ret. Sys. v. Coulter*, 2002 Del. Ch. Lexis 144, at *41 (Del. Ch. Dec. 18, 2002). Second, where, as here, a contract is unambiguous, extrinsic evidence may not be used to interpret the intent of the parties, or to vary the contract's terms so as to create ambiguity. *See Eagle Indus., Inc. v. DeVilbiss Health Care, Inc.*, 702 A.2d 1228, 1232 (Del. 1997). Here, § 5.02 is clear and unambiguous. It permits the GP to withdraw its incentive fee from its capital account as of the last day of any month. Thus, parole evidence of an alleged oral representation pre-dating the contract that contradicts its clear terms may not be considered and will not defeat the SR Defendants' motion for summary judgment.

[24] *Chase Manhattan Mortgage Corp. v. Advanta Corp.*, 2005 WL 2234608, at *13 (D. Del. Sept. 8, 2005).

[25] *Pellaton v. The Bank of New York*, 592 A.2d 473, 478 (Del. 1991).

place, because the Withdrawal took place on January 1, then § 5.02 was breached (requiring that withdrawals take place on the last day of the month). Even when drawing all reasonable inferences in favor of plaintiffs' allegations, in light of plaintiffs' own expert testimony discussed above, I can only conclude that the incentive fee was first allocated to the GP's Capital Account, and that the Withdrawal occurred, as of December 31. The SR Defendants did not breach § 9.01(b) or § 5.02 of the LPA.

Anticipating the timeline of such events, plaintiffs contend that if the Withdrawal occurred as of December 31, but was not reflected in the 1999 Financials, then defendants breached § 8.03 of the LPA. The unambiguous language of § 8.03, however, does not impose a duty of disclosure on defendants. The relevant section states in its entirety: "*Adjustments to Capital Accounts for Withdrawals*. The amount of withdrawals, if any, made by a Partner shall be deducted from such Partner's Capital Account as of the date of such withdrawal."[26] As stated earlier, the record clearly shows that the Withdrawal from the GP's capital account occurred as of December 31, precisely as § 8.03 contemplates. Consequently, the SR Defendants did not breach § 8.03 of the LPA.[27]

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[26] LPA § 8.03.

[27] I also note that even if plaintiffs were correct about a breach of contract, they suffered no damage as a result thereof. As will be discussed below, plaintiffs did not rely on the 1999 Financials (and any impression created that the GP remained invested in the Fund) because the Graces chose to maintain their investments in the Fund even after they learned of the GP's withdrawal. Consequently, the damages plaintiffs have alleged were not the result of any breaches of contract by the SR Defendants, even assuming such breaches existed (which I have rejected as a matter of law).

B. Count II: Breach of Fiduciary Duty

Plaintiffs charge that the GP breached its fiduciary duty by misstating that it had retained its entire incentive fee in its Capital Account when it had actually withdrawn nearly the entire incentive fee, by not disclosing such Withdrawal as a subsequent event, and by not disclosing that such Withdrawal was contrary to the LPA's express terms. Plaintiffs also contend that they relied upon such misstatements and omissions in determining whether or not to withdraw all or a portion of the funds from their Capital Accounts at the Fund. Such claims fail as a matter of law.

The GP was required to give the LPs quarterly reports and annual audited financial statements.[28] Because plaintiffs cannot establish reliance on the purported omitted disclosure of the Withdrawal, I need not consider whether the 1999 Financials should have disclosed the Withdrawal, and whether the Withdrawal should have been reported as a capital withdrawal on December 31, 1999, or as a subsequent event in the Subsequent Event footnote.

Despite allegations in their amended complaint that the plaintiffs relied upon the 1999 Financials in deciding to stay invested in the Fund in March 2000, plaintiffs changed course in their briefing on this motion and have instead argued that reliance can be "presumed" in a case involving an omission. Specifically,

[28] LPA § 12.05.

plaintiffs insist that in a case "involving primarily a failure to disclose,"[29] they are not required to prove reliance on what was not said. For this proposition, plaintiffs rely on federal precedents decided under Section 10(b) of the Securities Exchange Act of 1934 where, in certain situations, including under the "fraud on the market" theory, a presumption of reliance has been recognized.[30] Those federal decisions, however, are not persuasive or binding in the circumstances presented here. Delaware law does not recognize the fraud on the market theory.[31] Instead, in breach of fiduciary duty cases based on omissions, Delaware has limited the presumed reliance principle to cases where shareholder or partner action is requested. As the Delaware Supreme Court made clear in *Malone v. Brincat*, if a complaint does not allege statements made to shareholders in conjunction with a request for shareholder action, a plaintiff cannot rely on a "rebuttable presumption of reliance."[32] Here, as in *Malone*, no shareholder action was requested in conjunction with the alleged omission regarding the GP's incentive fee in the 1999 Financials. Accordingly, under Delaware law, plaintiffs are required to prove

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[29] *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153 (1972).
[30] *See id.*; *Sheehan v. Little Switzerland*, 136 F. Supp. 2d 301 (D. Del 2001); *Basic, Inc. v. Levinson*, 485 U.S. 224, 243-45 (1988).
[31] *Malone v. Brincat*, 722 A.2d 5, 13 (Del. 1998) ("In deference to the panoply of federal protections that are available to investors in connection with the purchase or sale of securities of Delaware corporations, this Court has decided not to recognize a state common law cause of action against the directors of Delaware corporations for 'fraud on the market.'"); *Manzo v. Rite Aid Corp.*, 2002 WL 31926606, at *4 (Del. Ch. Dec. 19, 2002) ("plaintiff cannot rely on a presumption of reliance based on a type of 'fraud on the market' theory because the Supreme Court has determined that Delaware does not recognize such a claim"), *aff'd*, 825 A.2d 239 (Del. 2003).
[32] *Malone*, 722 A.2d at 14; *Alessi v. Beracha*, 849 A.2d 939, 944 (Del. Ch. 2004).

reliance on the 1999 Financials and cannot rely on the rebuttable presumption of the fraud on the market theory.[33]

In February, upon the receipt of the 1999 Financials that disclosed an alarming 15% decline in Fund value, Metz recommended that John Grace withdraw from the Fund. John Grace decided to withdraw plaintiffs from the Fund for asset allocation reasons and because the Fund was shaky and volatile. John Grace's appeal to Oliver Grace to withdraw all Grace assets from the Fund was denied, so John withdrew only his own funds. John Grace admitted, however, that his decision to withdraw was unaffected by the GP's own capital investment:

> Q: So you wanted to get your money […] out of the S.R. Global Fund whether or not the general partner kept its special allocation fee for 1999 in the capital of the fund, right?
> John Grace: Yes.[34]

Upon receiving the Fund's 2000 first quarter statement that disclosed the GP's Withdrawal, the Graces continued to remain invested in the Funds. Ostensibly, this

[33] Even in the non-federal cases relied upon by the plaintiffs for their "presumed reliance" argument, all the cases except one involve omissions or misstatements in conjunction with shareholder action. *See Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 944 (Del. 1983) ("An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote."); *Zirn v. VLI Corp.*, 621 A.2d 773 (Del. 1993) (case analyzed duty of disclosure and materiality in light of a tender offer made to shareholders in connection with a merger); *Stroud v. Grace*, 606 A.2d 75, 84 (Del. 1992) (the duty of disclosure "represents nothing more than the well-recognized proposition that directors of Delaware corporations are under a fiduciary duty to disclose fully and fairly all material information within the board's control when it seeks shareholder action"). The only other case cited by plaintiffs, *Cannon v. Cherry Hill Toyota, Inc.*, 161 F. Supp. 2d 362 (D. N.J. 2001), involved consumer fraud under specific federal and New Jersey statutes.

[34] John Grace 248-49.

was due to the fact that the losses were already "locked-in."[35] The Graces remained invested in the Fund, *after learning of the GP's withdrawal*, for over another year and a half.

Plaintiffs' reliance theory therefore runs as follows: believing that the GP remained invested in the Fund, John Grace decided to *withdraw* from the Fund; however, upon learning that the GP no longer had skin in the game, the Graces decided to *continue* to remain invested. Taken at face value, the Graces preferred to remain in the Fund when they discovered that the GP withdrew, and to withdraw when they believed the GP still remained in the Fund. At the very least, it is painfully obvious that the status of the GP's investment in the Fund as reported in the 1999 Financials had nothing to do with the Grace's decision to remain invested in the Fund.[36]

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[35] John Grace 177 ("[T]he fund was really down and we decided to wait and see if it would recover."). Notably, John Grace could have applied a similar rationale to the withdrawal of his own investment earlier in February; upon learning of the 15% Fund decline in January and after receiving Metz's advice, John Grace did not wait to see if the Fund would recover.

[36] Defendants urge the Court to assess attorneys' fees against plaintiffs for their bad faith assertion of reliance. Although the factual record should have compelled plaintiffs to abandon their assertion of reliance (as defendants requested in a motion dated September 16, 2005), plaintiffs persisted in maintaining these dubious allegations. Additionally, there is evidence that the plaintiffs may have lied on multiple occasions in order to cobble together this lifeless theory: First, by response to interrogatory, plaintiffs identified Gerald White as the sole person with full authority to make investment decisions. DOB Ex. V. During his deposition, however, White disputed such claim, testifying that the Trustees also had such authority. DOB Ex. I at 26-29. Second, John Grace later swore that he, his brother Oliver, and John Klassen relied upon the 1999 Financials to stay invested. DOB Ex. WW. Putting aside whether Oliver could rely upon Financials he never read, but was only briefed on by John Grace, John Grace later admitted that he had little basis for assuming Klassen's reliance:

> Q: You don't know for a fact that it was Mr. Klassen who ever read the financial statement and relied upon it?
> John Grace: I don't know for a fact.

C. Count III: Negligence

Plaintiffs allege that the acts, omissions and conduct of the SR Defendants were performed and transacted carelessly and negligently and with a reckless disregard for the consequences thereof. The LPA, however, exculpates the SR Defendants from liability for negligent conduct. The LPA states that "[t]he General Partner and its affiliates … shall not be liable for honest mistakes in judgment or for losses due to such mistakes or for the negligence of employees, brokers or other

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> Q. Mr. Klassen never communicated to you that he had received and read the statement or relied upon it?
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> John Grace: No.

DOB Ex. A. at 278.

Klassen miraculously surfaced shortly thereafter, but even his sworn affidavit did little to straighten the crookedly growing story of reliance: Klassen did not independently review and analyze communications from the Fund, but relied on the Graces. Finally, Oliver Grace *swore in his affidavit* that "[w]hen John spoke with me in or about March 2000 concerning his view that we should withdraw from the Fund entirely, *my expressed view* was that although the Fund was sustaining losses in the near term, we should stay the course because the prior performance of the Fund had been good, and, over all, George Robinson had been a good money manager." POB Ex. FFF ¶ 4 (emphasis added). Such justification for remaining invested in the fund is contradicted by Oliver Grace's own, sworn deposition testimony regarding the March events:

> Q: And did [John Grace] make a recommendation to you as to whether Anglo American, Diversified and/or Drake should withdraw from the fund, the S.R. International Fund?
>
> Oliver Grace: He asked me whether we should withdraw.
>
> Q: And what did you say?
>
> Oliver Grace: I said I'd like to stay with it.
>
> Q: *Did you give him reasons why?*
>
> Oliver Grace: *No.*

Oliver Grace 32 (emphasis added).

Though I am tempted to find bad faith, it is arguable that plaintiffs were operating under an incredibly tenuous conception of reliance that need not be consistent with past behavior (John Grace's early withdrawal) or future actions (the Graces' staying in the Fund after May 6), nor have anything to do with actually reading the document upon which the Graces allegedly relied. Additionally, I will attribute contradictory responses in affidavits, interrogatories and depositions to the moss that gathers on five-year-old memories. Accordingly, I cannot conclude that plaintiffs were acting in bad faith and, therefore, I will not shift attorneys' fees to plaintiffs.

agents of the Partnership."[37] Plaintiffs' allegations of misconduct rise only to the level of negligence; they come nowhere near the "devil-may-care attitude" required of recklessness.[38] Therefore, even if (arguendo) defendants made mistakes, those mistakes were innocent mistakes at worst, and liability for them is barred by the LPA.

Additionally, Section 17-407 of the DRULPA fully protects a general partner from liability to its limited partners when the general partner relies in good faith upon those charged with properly preparing and presenting the financial records of the partnership.[39] The undisputed evidence demonstrates that the GP relied in good faith upon IFS to administer the Fund and upon E&Y to prepare the Fund's audited financial statements. Having relied upon these professionals and with no evidence of willful misconduct or gross negligence in so relying, the SR Defendants are also protected from liability by Section 17-407.

Finally, plaintiffs did not rely upon the alleged false disclosures in respect to both the contract claims and the fiduciary duty claims. Plaintiffs similarly fail to prove reliance here, or any damages that were the result of such reliance, in this context of a negligence claim against the SR Defendants. Without this essential element, plaintiff's negligence claim fails.

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[37] LPA § 3.04(a).
[38] *Albert v. Alex. Brown Mgmt. Serv., Inc.*, 2005 WL 2130607, at *4 (Del. Ch. Aug. 26, 2005).
[39] 6 *Del. C.* § 17-407(c) (2005).

D. Count IV: Claims Against E&Y

Plaintiffs allege that E&Y should be liable for negligent misrepresentation, aiding and abetting, and breach of contract. Plaintiffs cannot succeed on their claim for negligent misrepresentation because plaintiffs did not rely on the 1999 Financials. In order to prevail on a claim for negligent misrepresentation, plaintiffs must demonstrate that E&Y has a pecuniary duty to provide accurate information to the plaintiffs, that E&Y supplied false information, that E&Y did not exercise reasonable care in obtaining or communicating the information, and that plaintiffs experienced a pecuniary loss caused by justifiable reliance on the false information.[40] As stated earlier, evidence in the record clearly demonstrates that plaintiffs did not rely on the 1999 Financials when remaining in the Fund. Consequently, without addressing the other elements of this claim, plaintiffs' claim against E&Y for negligent misrepresentation is dismissed.

Plaintiffs allege that E&Y aided and abetted a breach of fiduciary duty. Because there has been no breach of the GP's fiduciary duty, the aiding and abetting claim against E&Y must fail.[41]

Finally, plaintiffs assert a contract claim against E&Y under the theory that plaintiffs were a third-party beneficiary to contracts between E&Y and other

[40] *See Darnell v. Myers*, 1998 WL 294012, at *5 (Del. Ch. May 27, 1998).
[41] *See Goodwin v. Live Entm't, Inc.*, 1999 WL 64265, at *28 (Del. Ch. Jan. 25, 1999).

defendants. Such claims, sounding in contract against E&Y, were dismissed in this Court's earlier ruling, and will not be addressed again.[42]

E. Count V: Reiteration of All Prior Claims and Allegations

Because Count V merely rehashes all prior claims and allegations, and because this Court has granted summary judgment in favor of defendants on all earlier claims and allegations, summary judgment is hereby granted on Count V in favor of defendants.

An Order has been entered consistent with the conclusions reached in this Memorandum Opinion.

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[42] *Anglo American Sec. Fund, L.P. v. S.R. Global Int'l Fund, L.P.*, 829 A.2d 143, 151 (Del. Ch. Aug. 4, 2003).