IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN RE: ARROW INVESTMENT ADVISORS, LLC,	)	
	)	C.A. No. 4091-VCS
a Delaware limited liability company.	)	

MEMORANDUM OPINION

Date Submitted: February 11, 2009
Date Decided: April 23, 2009

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STRINE, Vice Chancellor.

I. Introduction

Before me is a motion to dismiss a petition for dissolution (the "Petition") of a limited liability company, respondent Arrow Investment Advisors, LLC. The Petition is brought by Noah Hamman, who is one of the three co-founders of Arrow, and who was removed from management of the company by the other two co-founders nearly a year and a half ago. The Petition alleges that the current managers have failed to fulfill Arrow's original business plan and, in a conclusory manner, that the managers breached their fiduciary duties in a variety of ways. Hamman argues that these circumstances support a dissolution order because they have caused it to be no longer reasonably practicable to carry out Arrow's business.

In this opinion, I grant Arrow's motion to dismiss the Petition. In determining whether an LLC should be dissolved because it is no longer reasonably practicable to carry on the business of the LLC, this court must look to the operating agreement of the LLC to determine the purpose for which it was formed, and not to an initial business plan that any rational businessperson would expect to evolve over time. Here, Hamman has failed to allege that Arrow is not operating in accordance with the broad purposes set forth in its LLC agreement (the "Arrow LLC Agreement").

Moreover, I will not entertain a claim for dissolution premised on unproven breaches of fiduciary duty. Dissolution is an extreme remedy to be applied only when it is not longer reasonably practicable for the company to operate in accordance with its founding documents, not as a response to fiduciary or contractual violations for which more appropriate and proportional relief is available. And, in many instances, such

fiduciary and contractual claims may be subject to important, policy-based rules governing how they may be brought — such as the demand rule in the case of derivative claims or the rules favoring alternative dispute resolution where the parties have elected it — rules that would be bypassed if the claims were allowed to be first raised in a dissolution action. For these reasons, parties should first prove their fiduciary claims in a plenary action, and then seek dissolution only if the remedy granted in that action is insufficient to make continuation of the entity in accordance with its operating agreement reasonably practicable.

Here, Hamman was required to press his fiduciary claims in binding arbitration under the Arrow LLC Agreement. Having failed to do so, and having failed to plead any factual support for his claims, Hamman has not demonstrated that the conduct of Arrow's managers has frustrated the purpose for which Arrow was formed.

Because the Petition fails to adequately plead that Arrow is not operating in accordance with the Arrow LLC Agreement, or that it would be impracticable for Arrow to do so, I dismiss the Petition.

II. Factual Background

Arrow was formed in February 2006 by Noah Hamman, Joseph Barrato, and Jacob Griffith, and together these three initially comprised Arrow's management committee. Arrow was formed "for the purpose of acting as an investment adviser to certain investment funds *and for such other lawful business as the Management Committee*

chooses to pursue."[1] Hamman, who has a 30% membership interest in Arrow, served as the CEO of Arrow until November 30, 2007, when he was removed by the other two managers, Barrato and Griffith, over disputes about the management and strategic direction of Arrow. Barrato and Griffith are now the only members of Arrow's management committee.

Like many investment companies, Arrow encountered difficulties in 2008, and on September 24, 2008, Arrow sent a financial report to its members showing that Arrow was operating at an almost $275,000 loss for the first seven months of 2008.[2] In the same notification, Arrow indicated that its management committee had decided to explore additional, investment-related business avenues for Arrow — including organizing a research unit for developing new investment strategies and products, and establishing an off-shore holding company — and sought capital contributions from Arrow's members to support those ventures.[3]

On October 10, 2008, Hamman filed the Petition seeking judicial dissolution under §18-802 of the Delaware LLC Act.[4] According to Hamman, judicial dissolution is warranted because, "Barrato and Griffith[] have mismanaged the Company and its

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[1] Petition ("Pet."), Exhibit A ("Arrow LLC Agreement") § 2.1 (emphasis added).
[2] Pet. ¶ 6.
[3] Respondent's Opening Brief, Exhibit A ("Cash Call Letter"). The Cash Call Letter was incorporated by reference into the Petition. *See* Pet. ¶¶ 6, 11. The Petition seeks declaratory judgment that this capital call is void, but Hamman has since withdrawn that claim on the basis that this court does not have subject matter jurisdiction over it under the broad arbitration clause in the Arrow LLC Agreement. Transcript of 2/11/09 ("Tr.") at 14-15.
[4] The Arrow LLC Agreement specifically names, as one of four possible events triggering dissolution, "the entry of a decree of judicial dissolution under 6 *Del. C.* § 18-802." Arrow LLC Agreement § 2.5(d). Hamman does not contend that any of the other dissolution triggers contained in the Arrow LLC Agreement are applicable here.

business operations in several respects so as to prevent and frustrate the successful achievement of the business plan, goals, and objectives of the Company."[5] The mismanagement that Hamman cursorily alleges in his minimalist, five-page Petition includes violating various securities laws, using company funds for personal expenditures at the expense of paying employees on time, and failing to provide an annual operating plan for 2008 as required by the Arrow LLC Agreement. Hamman also complains that the business plan that was drafted when Arrow was formed called for Arrow to be profitable by the time it had a certain level of assets under management, implying that Arrow's management is ineffective because Arrow secured greater assets under management than the plan anticipated, but nevertheless sustained losses instead of reaping profits.[6]

Arrow now seeks dismissal of the Petition on the basis that Hamman has not alleged any facts from which it can reasonably inferred that it is not reasonably practicable to carry on the business of the LLC, as required by § 18-802.

III. Legal Analysis

A. Legal Standards

To state a claim under Rule 12(b)(6), "a complaint must plead enough facts to plausibly suggest that the plaintiff will ultimately be entitled to the relief she seeks."[7] In determining whether a claim is stated, I must accept all well-pled facts as true and draw

[5] Pet. ¶ 7.
[6] Pet. ¶ 6.
[7] *Desimone v. Barrows*, 924 A.2d 908, 929 (Del. Ch. 2007).

all reasonable inferences in the light most favorable to the plaintiff.[8] But, I need not accept conclusory assertions unsupported by specific factual allegations.[9]

In this case, Hamman must allege specific facts supporting a rational inference that the standard set forth in § 18-802 for judicial dissolution has been met.[10] Specifically, Hamman must demonstrate that "it is not reasonably practicable to carry on the business in conformity with [the] limited liability company agreement."[11] The determination of whether the business of an LLC is no longer practicable to carry on is left to the discretion of the court.[12]

Given its extreme nature, judicial dissolution is a limited remedy that this court grants sparingly.[13] The court will not dissolve an LLC merely because the LLC has not experienced a smooth glide to profitability or because events have not turned out exactly

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[8] *In re Lukens, Inc. S'holders Litig.*, 757 A.2d 720, 727 (Del. Ch. 1999), *aff'd* 757 A.2d 1278 (Del. 2000).

[9] *Grobow v. Perot*, 539 A.2d 180, 187 n.6 (Del. 1988).

[10] In interpreting the requirements of § 18-802, I draw on case law interpreting analogous provisions related to other forms of entities. *See In re Silver Leaf, L.L.C.*, 2005 WL 2045641, at *10 (Del. Ch. Aug. 18, 2005) ("[T]he court looks by analogy to the dissolution statute for limited partnerships, 6 *Del. C.* § 17-802, which contains essentially the same wording as the LLC statute."); *Haley v. Talcott*, 864 A.2d 86, 94 (Del. Ch. 2004) (applying 8 *Del. C.* § 273, regarding dissolution of joint ventures, by analogy).

[11] 6 *Del. C.* § 18-802.

[12] *See* 6 *Del. C.* § 18-802 ("[T]he Court of Chancery *may* decree dissolution of a limited liability company . . . ." (emphasis added)); *Haley*, 864 A.2d at 93; *see also* ROBERT L. SYMONDS, JR. & MATTHEW J. O'TOOLE, DELAWARE LIMITED LIABILITY COMPANIES §16.02[E][4] (2006) ("[T]he entry of a decree of dissolution still rests in the discretion of the Delaware Court of Chancery.").

[13] *See In re Seneca Invs. LLC*, -- A.2d --, 2008 WL 5704773, at *1 (Del. Ch. Sept. 23, 2008) ("The Court of Chancery has limited statutory power to order dissolution of an LLC."); *Active Asset Recovery, Inc. v. Real Estate Asset Recovery Servs., Inc.*, 1999 WL 743479, at *6 (Del. Ch. Sept. 10, 1999) ("As a general matter, this court's power to dissolve a partnership . . . is a limited one and should be exercised with corresponding care." (internal quotations omitted)); *Cincinnati Bell Cellular Sys. Co. v. Ameritech Mobile Phone Serv. of Cincinnati, Inc.*, 1996 WL 506906, at *11 (Del. Ch. Sept. 3, 1996) ("The Court of Chancery's power to order dissolution and sale . . . is a narrow and limited power.").

as the LLC's owners originally envisioned; such events are, of course, common in the risk-laden process of birthing new entities in the hope that they will become mature, profitable ventures.[14] In part because a hair-trigger dissolution standard would ignore this market reality and thwart the expectations of reasonable investors that entities will not be judicially terminated simply because of some market turbulence, dissolution is reserved for situations in which the LLC's management has become so dysfunctional or its business purpose so thwarted that it is no longer practicable to operate the business, such as in the case of a voting deadlock or where the defined purpose of the entity has become impossible to fulfill.[15]

Here, Hamman's allegations that Arrow is currently failing to achieve its "business plan, goals, and objectives"[16] and that Arrow's managers have breached their fiduciary duties fall far short of this threshold.

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[14] *See, e.g.*, *Seneca*, 2008 WL 5704773, at *3 (declining to dissolve an LLC that was acting as a passive instrumentality, a lawful purpose within the scope of the LLC's broad purpose clause, rather than an active business); *Cincinnati Bell*, 1996 WL 506906, at *7 (declining to dissolve a limited partnership where regulatory changes increased competition in the partnership's industry because, although the partnership's financial outlook was weakened, it could still provide a return for its investors); *Red Sail Easter Ltd. Partners, L.P. v. Radio City Music Hall Prods., Inc.*, 1993 WL 287620, at *28 (Del. Ch. July 28, 1993) (denying petition to dissolve a limited partnership that alleged the managers of the partnership were not maximizing the returns on the partnership's exclusive license to produce an Easter show at Radio City Music Hall where there was no credible evidence that the general partner had "not carefully and loyally fully exploited the commercial value" of the license).

[15] *See, e.g.*, *Silver Leaf*, 2005 WL 2045641, at *11 (granting dissolution where there was a voting deadlock); *Haley*, 864 A.2d at 89 (same); *PC Tower Ctr., Inc. v. Tower Ctr. Dev. Assocs. Ltd. P'ship*, 1989 WL 63901, at *6 (Del. Ch. June 8, 1989) (granting dissolution where the sole purpose of a limited partnership was to own and operate certain real property and where that was purpose was frustrated because market conditions made finding a tenant "practically impossible").

[16] Pet. ¶ 7.

B. The Petition Does Not Allege That Arrow Cannot Practicably Operate In Accordance With Its LLC Agreement

In essence, Hamman's argument is that Arrow should be dissolved because it is not meeting the performance projections contained in the business plan Arrow's founders drafted at the time they formed Arrow and because Arrow is now pursuing strategies that were not part of that business plan. But, this argument does not suggest that Arrow is suffering the rare fate of being a company that is unable to operate in accordance with its governing document. Instead, the Petition suggests on its face that Arrow's management is in the common situation of discovering that its original plans need some revision, a situation that Hamman's counsel acknowledged "a great many" startups find themselves in.[17] And, although Hamman might be disappointed that he has been ousted from the management of a company he helped establish, disagree with the tack its current managers are taking, and wish to take his capital out of the company, these are not circumstances from which I can reasonably infer that it has become impracticable for Arrow to provide a return to its investors by engaging in "such . . . lawful business as the Management Committee chooses to pursue."[18]

In this regard, Hamman's argument that Arrow's purpose clause should be read narrowly is inconsistent with the language of the Arrow LLC Agreement itself. Hamman asserts that the LLC Agreement should be read as only authorizing Arrow to engage in strictly investment advisory services — and not the new research and off-shore activities that Arrow's management has proposed — and that Hamman should be allowed to move

[17] Tr. at 19.
[18] Arrow LLC Agreement § 2.1.

to trial to prove that Arrow cannot fulfill this narrowed purpose. In doing so, Hamman asks the court to ignore the entire clause of the Arrow LLC Agreement that authorizes Arrow to engage in "such other lawful business as the Management Committee chooses to pursue."[19] Hamman's argument against giving effect to the plain meaning of this broad language is that to do so would mean it would never be impracticable to operate an entity created to pursue any lawful business purpose, so such an entity could never be dissolved by judicial order, which would in turn render this court's dissolution power meaningless. In other words, Hamman argues that one must read broad purpose clauses narrowly to avoid making § 18-802 a superfluous statute.

That argument is unpersuasive. Dissolution of an entity chartered for a broad business purpose remains possible upon a strong showing that a confluence of situationally specific adverse financial, market, product, managerial, or corporate governance circumstances make it nihilistic for the entity to continue.[20] In other words, a petitioner might obtain dissolution by making a convincing showing that the perpetuation of the entity, irrespective of its managers' intentions to pursue a business line allowed by its governing instrument, was obviously futile and would not result in business success. One need not speculate on exactly what circumstances of that type might suffice to make

[19] Arrow LLC Agreement ¶ 2.1.

[20] For example, in *McGovern v. Gen. Holding, Inc.*, 2006 WL 1468850 (Del. Ch. May 18, 2006), this court dissolved a limited partnership because it was unlikely that the general partner and 90% owner who committed a variety of fiduciary and contractual breaches would "mend his ways and begin to act as a trustworthy general partner," but it was also unlikely that the partnership would be viable under substitute management given the general partner's large ownership stake and the importance of his knowledge and skills to the business. *Id.* at *24. In that case, the partnership agreement contained a relatively narrow purpose clause, but the concerns animating the holding would seem applicable to an entity with a broader purpose.

that showing in order to confidently conclude that Hamman cannot state a claim for dissolution by simply alleging that a two-year-old LLC with a broad purpose clause has experienced some adversity and therefore ought to be dissolved. By that standard, investors could state a claim for dissolution against virtually all entities on a regular basis, especially in years of economic turbulence like this one.

Moreover, an important reason for parties to include a broad purpose clause in an entity's governing instrument is to ensure that the entity has flexibility to adapt in the face of changing circumstances. Having agreed to such a clause in the Arrow LLC Agreement, and therefore having contemplated that Arrow may one day be something other than an investment advisor, Hamman cannot now seek to prematurely end Arrow's existence because he is unhappy with how Arrow's management chose to exercise its discretion.

C. Hamman's Breach Of Fiduciary Duty Allegations Do Not Support Dissolution

Hamman alleges in a cursory way that Barrato and Griffith have committed a variety of breaches of their fiduciary duties to Arrow and to Hamman. These allegations suffer from a number of deficiencies.

For starters, Hamman has failed to allege any specific facts supporting a reasonable inference that Barrato and Griffith breached their fiduciary duties. The entirety of Hamman's allegations are stated in three, brief paragraphs:

> 8. Specifically, the managers have exposed the Company to liability by violating the particular federal securities laws and regulations under which the Company is required to operate, and have failed to seek appropriate supervision from the broker-dealer for the Company's specific obligations as a FINRA-licensed representative.

> 9. The managers have also operated the Company for their own financial benefit, and have spent Company funds for their own private use and enjoyment, while paying wages to various employees in an erratic and tardy fashion.
>
> 10. The managers of the Company have also failed to provide to all members an annual operating plan for 2008 as required by the LLC Agreement.[21]

Hamman suggests that merely stating these allegations, virtually without any factual support, is enough to survive a motion to dismiss. But our law has long required that a plaintiff plead some set of facts that plausibly suggest she is entitled to relief.[22] Here, the Petition is devoid of any facts supporting Hamman's first two allegations,[23] such as which of the myriad federal securities laws Arrow must comply with were violated or for what improper personal purposes Barrato and Griffith used Arrow funds and approximately when and how much of Arrow's funds they misused. Nor do the pleadings provide any rational basis for inferring that any of these alleged breaches are of the type that would justify the extreme remedy of dissolution. Regrettably, breaches of

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[21] Pet. ¶¶ 8-10.

[22] *See Grobow v. Perot*, 539 A.2d 180, 187 n.6 (Del. 1988); *Desimone v. Barrows*, 924 A.2d 908, 928-29 (Del. Ch. 2007); *Weinberger v. UOP, Inc.*, 409 A.2d 1262, 1264 (Del. Ch. 1979); *Perry v. Missouri-Kansas Pipe Line Co.*, 191 A. 823, 828 (Del. Ch. 1937).

[23] Admittedly, Hamman's allegation that Barrato and Griffith "failed to provide to all members an annual operating plan for 2008 as required by the LLC Agreement, " Pet. ¶ 10, may be factually sufficient, but it is also the type of allegation that this court has expressly stated will not support dissolution of an LLC:

> Petitioner argues that dissolution is proper because Seneca has failed to comply with certain provisions of the Operating Agreement that allegedly require, among other things, that the Company . . . provide reports to the Company's stockholders . . . . Even assuming that Seneca is in violation of some provisions of its operating agreement, such violations are not grounds for this Court to order dissolution of an LLC. The role of this Court in ordering dissolution under § 18-802 is limited, and the Court of Chancery will not attempt to police violations of operating agreements by dissolving LLCs.

Seneca, 2008 WL 5704773, at *3.

fiduciary duty of varying degrees of seriousness are not unknown in the business world. But it is rare for these breaches to rise to such a level that the appropriate remedy for them is the termination of the corporate existence itself. [24]

Moreover, by raising fiduciary claims in his Petition for dissolution, Hamman is skirting important, policy-based rules governing such claims. Because many claims for breach of fiduciary duty belong to entities rather than their equity holders, the law has developed rules for the bringing of derivative claims, including the rule that a plaintiff must first make demand on the company's management. Specifically, in the LLC context, the LLC Act requires that "[i]n a derivative action, the complaint shall set forth with particularity the effort, if any, of the plaintiff to secure initiation of the action by a manager or member or the reasons for not making the effort."[25] The demand rule "exists at the threshold to prevent abuse and to promote intracorporate dispute resolution."[26] The

[24] One rare example occurred in *Silver Leaf*, where this court dissolved an LLC that had been formed to market and distribute a French fry vending machine made by Tasty Fries, Inc. The court found that, in addition to being unable to operate due to a voting deadlock and having a moot business purpose, the company was essentially nothing other than a vehicle for fraud because the founders never intended that Tasty Fries would deliver a commercially viable vending machine, but nevertheless intended to sell marketing sublicenses to unwary investors. 2005 WL 2045641, at *13. Similarly, dictum in *Metro Communication Corp. BVI v. Advanced Mobilecomm Technologies Inc.*, 854 A.2d 121 (Del. Ch. 2004) suggested that a party might have been able to seek judicial dissolution of an LLC created to operate a telecommunications network in Brazil if the party had proven that the managers of the LLC engaged in a bribery scheme that, once it became public in Brazil, so impaired the company's credibility that it could not obtain the permits it needed to operate. *Id.* at 145 n.46. In both *Silver Leaf* and *Metro*, the scenarios at issue involved misconduct that so materially hampered the company's ability to perform its business purpose that continuation would have been impracticable even after drastic relief, such as removal of management.

[25] 6 *Del. C.* § 18-1003.

[26] *Pogostin v. Rice*, 480 A.2d 619, 624 (Del. 1984).

purpose of demand is, in part, to give corporate managers an opportunity to address alleged wrongs without subjecting the entity to costly litigation.[27]

The important policy function served by the demand rule cannot be lightly bypassed by immediate resort to a dissolution action under § 18-802, which is designed to serve an important but nevertheless narrow function.[28] Rather, both because dissolution is a remedy of last resort and because of the limitations imposed on derivative actions, a claim for dissolution premised on breaches of fiduciary duty only states a claim if the plaintiff pleads that: 1) she has proven the fiduciary breaches in a plenary action; and 2) there remains a rational basis for a dissolution remedy notwithstanding the remedy granted in the plenary action.

In this regard, Hamman's attempt to raise fiduciary claims in this court, as opposed to arbitration, raises another issue of improper bypass of policy-based rules for

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[27] *See Braddock v. Zimmerman*, 906 A.2d 776, 784 (Del. 2006) ("The demand requirement of Rule 23.1 is a 'substantive right designed to give a corporation the opportunity to rectify an alleged wrong without litigation, and to control any litigation which does arise.'" (quoting *Aronson v. Lewis*, 473 A.2d 805, 809 (Del. 1984))); *Grimes v. Donald*, 673 A.2d 1207, 1216 (Del. 1996) ("[B]y requiring exhaustion of intracorporate remedies, the demand requirement invokes a species of alternative dispute resolution procedure which might avoid litigation altogether."); *Rattner v. Bidzos*, 2003 WL 22284323, at *7 (Del. Ch. Sept. 30, 2003) ("The hurdle of proving demand futility also serves an important policy function of promoting internal resolution, as opposed to litigation, of corporate disputes and grants the corporation a degree of control over any litigation brought for its benefit.").

[28] *See Seneca*, 2008 WL 5704773, at *3 ("The role of this Court in ordering dissolution under § 18-802 is limited, and the Court of Chancery will not attempt to police violations of operating agreements by dissolving LLCs."); *In re Cambridge Fin. Group, Ltd.*, 1987 WL 19677, at *3 (Del. Ch. Nov. 9, 1987) ("Actions which are adversarial in nature, such as requesting relief from a breach of a fiduciary duty and the impressing of a trust upon corporate opportunities taken by a director, are not matters directly related to a dissolution proceeding and cannot be raised therein."); *In re Arthur Treacher's Fish & Chips of Ft. Lauderdale, Inc.*, 386 A.2d 1162, 1165-66 (Del. Ch. 1978) (dismissing counterclaims alleging, among other things, breaches of fiduciary duty from § 273 dissolution proceeding because they were beyond the scope of the action).

bringing claims. The Arrow LLC Agreement requires that "any questions, issues, or disputes arising out of or relating to this Agreement" first be handled though negotiation, then mandatory mediation, and then finally binding arbitration.[29] This provision is in keeping with the Delaware policy favoring alternative dispute resolution mechanisms.[30] Hamman cannot use §18-802 as an end-run around the dispute resolution clause in the Arrow LLC Agreement. Rather, Hamman should press his fiduciary complaints in accordance with procedure specified in the Arrow LLC Agreement requiring negotiation, mediation, and then binding arbitration.[31]

IV. Conclusion

For the foregoing reasons, respondent Arrow Investment Advisors, LLC's motion to dismiss the Petition is granted, and the Petition is dismissed with prejudice, except that Arrow may seek dissolution at the end of the arbitration process if it has proven breaches of fiduciary duty and can make a good faith argument that, notwithstanding the remedies granted by the arbitrator, those breaches support an order of dissolution. IT IS SO ORDERED.

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[29] Arrow LLC Agreement § 13.14. The parties agree that this court has jurisdiction to hear the Petition for dissolution notwithstanding the broad arbitration provision in the Arrow LLC Agreement. Respondent's Opening Brief at 17 n.8; Petitioner's Opposition Brief at 10; *see also Willie Gary LLC v. James & Jackson LLC*, 2006 WL 75309, at *10 (Del. Ch. Jan. 10, 2006) (holding that party was not required to arbitrate dissolution claim where LLC agreement specifically contemplated judicial dissolution), *aff'd* 906 A.2d 76 (Del. 2006).

[30] *See Elf Atochem N. Am., Inc. v. Jaffari*, 727 A.2d 286, 292 (Del. 1999) (noting that an arbitration provision in an LLC agreement "foster[ed] the Delaware policy favoring alternate dispute resolution mechanisms, including arbitration" and that "[s]uch mechanisms are an important goal of Delaware legislation, court rules, and jurisprudence" (citations omitted)).

[31] As of oral argument, this process had been initiated by Barrato and Griffiths, and the parties were in the preliminary stages of an arbitration proceeding.