



IN THE SUPREME COURT OF THE STATE OF DELAWARE

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

CORRECTED

**PLAINTIFFS' BELOW, APPELLEES' ANSWERING SUPPLEMENTAL
MEMORANDUM CONCERNING THE ISSUE REMANDED**

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NATURE OF PROCEEDINGS

This action 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"). R&R Capital LLC and FTP Capital LLC (collectively, "R&R") contributed the bulk of the initial capital (over \$9.7 million), and 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 eight 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 (by Merritt) to the U.S. Supreme Court. Despite the convoluted procedural history, the core dispute concerned the proper interpretation of a manager removal provision in the LLCs' operating agreements ("LLC Agreements").

In August 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 and the case was assigned to Chancellor William B.

Chandler III. Shortly thereafter, after briefing and oral argument, the Trial Court entered a *status quo* order.

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") (emphasis added throughout, unless otherwise noted). 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 (the "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.

In April 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 was no longer a question concerning whether Merritt, in fact, "engaged in fraud," and Merritt was (and 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. Therefore, R&R sought a summary judgment from the Trial Court.

During a teleconference in July 2009, the Trial Court denied a "renewed" motion by Merritt to modify the then-existing *status quo* order to permit her to use or sell the LLCs' assets to advance herself attorneys' fees ("Status Quo Ruling").

In September 2009, the Trial Court issued a summary judgment against Merritt – confirming the validity of her removal as manager as of August 20, 2008 – and appointed an independent receiver to wind up the affairs of the LLCs.

In February 2011, after the LLCs were wound up, the Trial Court discharged the independent receiver and concluded the Trial Court proceedings.

In March 2011, Merritt appealed the final order entered by the Trial Court, which encompasses all prior orders entered by the Trial Court.

In January 2013, after briefing and oral argument, the Supreme Court remanded this action to address whether the Trial Court's Status Quo Ruling was supportable ("Remand Order"). In relevant part, the Remand Order states:

2) The trial court's ruling on Merritt's motion for advancement of fees was the following statement made during a teleconference:

THE COURT: Am I correct that there's also ... a motion filed and pending that requests that I modify the

status quo order to allow advancement of fees to Ms. Merritt?

COUNSEL FOR MERRITT: yes

THE COURT: All right. Well, then, let me address that. My view is that no one should be advanced any fees in this litigation - neither Ms. Merritt nor any of the plaintiffs 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....

5) As the transcript quoted above reveals, the trial court did not provide the reasoning and legal support for its decision denying advancement of fees. Inasmuch as the judge who made that ruling has retired from the bench, we cannot remand for clarification of the basis for his decision. Nonetheless, the Court considers it a threshold issue since Merritt's lack of counsel may have impacted subsequent substantive decisions.

6) Accordingly, this case will be remanded to obtain a decision on the advancement issue from a newly-assigned judge. Specifically, the trial court should answer the following question:

Is the trial court's decision to defer ruling on the advancement of attorneys' fees supportable? Whether it is or is not, please explain the basis for your conclusion.

7) In addressing this question, the trial court should not consider whether Merritt suffered any prejudice, either because the decision removing Merritt for cause was correct, or because the assistance of counsel could not have changed the result.

The Trial Court transcript ruling quoted in the above Remand Order, was the July 2009 Status Quo Ruling, which denied the "renewed" motion by Merritt to modify the then-existing *status quo* order.

On January 17, 2013, Vice Chancellor Sam Glasscock, III, convened a teleconference to address a schedule for completing the remand proceedings by March 15, 2013.¹ During that teleconference, the Trial Court stated its understanding of the narrow issue on remand:

THE COURT: ... I ... think it's inherent, although not specific, from that [Remand O]rder that I cannot determine at this stage whether [Merritt] was entitled to advancements, only consider whether ... it was an abuse of discretion to so order the decisions in the case in the way that they were ordered. So ... to the extent you are making an argument on that narrow issue that wasn't presented to the Court below,... I need to know that. I will let you argue whatever you want to, but I need to know whatever argument it is you are relying on as far as abuse of discretion was presented to the Chancellor. Because as I understand my mandate, it is as much as possible to consider this question in light of the circumstances that existed in front of [the Trial Court]....

Merritt's counsel did not object, or otherwise dispute the Trial Court's characterization of the narrow issue on remand.

¹ Exhibit A (scheduling conference transcript).

After briefing and oral argument,² the Trial Court concluded that the Status Quo Ruling is supportable ("Remand Decision"). Based upon what was known to the Trial Court as of July 2009, the Remand Decision found:

- the *status quo* order was entered to prevent Merritt from dissipating LLC assets – based upon allegations by R&R that LLC assets were unaccounted for, and that Merritt had been looting the LLCs by engaging in fraudulent transactions with her boyfriend, Leonard Pelullo, a convicted criminal;
- adequate grounds existed to support *three separate status quo* orders, and Merritt bore the burden of establishing good cause for any modification;
- facts had arisen by July 2009 that reinforced the risk that Merritt would dissipate LLC assets, including the PA Fraud Opinion and the May 2009 contempt proceedings related to Merritt's large cash withdrawals (~\$150k);
- "the record contains substantial evidence that, in the absence of the Status Quo Order, there was a substantial risk that the [LLC] assets in dispute could have been misappropriated by Merritt";
- the Trial Court was "suspicious, and justifiably so, of Merritt's motives in seeking to modify the Status Quo Order," and there was "ample support for the [Trail Court]'s decision to defer ruling on advancement."
- prior to July 2009, during which time Merritt was represented by counsel, "the deferral of Merritt's advancement claims was a result of her own litigation strategy," including seeking to stay the Delaware proceedings (a litigation strategy that ultimately back-fired); and
- "a sufficient basis existed to support the [Trail Court]'s decision that Merritt had failed to meet her burden to show that the [Trial] Court should modify the Status Quo order. [The Trail Court], therefore, had the discretion to maintain the Status Quo Order."

² Exhibits B-E (remand briefing); F (March 5, 2013) (remand oral argument transcript).

SUMMARY OF ARGUMENT

I. Denied – although the issue raised by Merritt is not properly before this Court. The question on remand was whether the Status Quo Ruling was supportable. That ruling 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, the Status Quo Ruling denied a motion to modify the existing *status quo* order to permit Merritt to use or sell the LLCs' assets to advance herself attorneys' fees. The effect of the Status Quo Ruling was – as acknowledged by the Remand Order – to defer resolution of the advancement dispute. As for the Remand Decision, it did not decide the substantive dispute concerning advancement either. Therefore, the issue raised in Argument I by Merritt is not properly before this Court. Nevertheless, any contractual right to advancement Merritt had pursuant to Section 9.1 terminated as of August 20, 2008, by operation of the unambiguous terms of Section 4.5 of the LLC Agreements.

II. Denied. The Remand Decision properly: (i) focused on the Status Quo Ruling that was specifically identified in the Remand Order, (ii) treated the Status Quo Ruling as resolving Merritt's "renewed" motion to modify the then-existing *status quo* order, and (iii) concluded that Chancellor Chandler acted within his discretion when entering the Status Quo Ruling based upon the facts known to the Trial Court at that time.

ARGUMENT

I. THE REMAND DECISION WAS NOT ERRONEOUS.

A. Question Presented.

Whether the Remand Decision was erroneous.

B. Scope Of Review.

The Status Quo Ruling resolved a motion to modify an existing *status quo* order to permit Merritt to use or sell the LLCs' assets to advance herself attorneys' fees. The Remand Decision, in turn, analyzed whether the Status Quo Ruling was "supportable." Therefore, the Remand Decision is subject to an abuse of discretion standard because this Court reviews decisions to enter, deny, enforce, modify or maintain a *status quo* order under an abuse of discretion standard.³

C. Merits Of Argument.

Merritt's opening supplemental brief ("Merritt OB") raises three arguments, each of which are addressed below.

1. By Its Plain Terms, The Remand Order Was Limited To The Status Quo Ruling (Merritt OB 8-9)

Merritt argues that the Remand Order was erroneous because the Trial Court "failed to examine all of the orders deferring advancement." Merritt OB 8. Yet, it cannot be reasonably contested that the Remand Order directed the Trial Court to

³ See, e.g., *Lawson v. Meconi*, 897 A.2d 740, 743 (Del. 2006); *Hallett v. Carnet Holding Corp.*, 809 A.2d 1159, 1162 n.9 (Del. 2002).

determine whether the Status Quo Ruling – and only that decision – was supportable. For example, paragraph 2 of the Remand Order identifies the Status Quo Ruling as the relevant Trial Court decision, and quotes the transcript from that July 2009 hearing. Paragraph 5 refers to the lack of "reasoning and legal support" in that transcript. Finally, paragraph 6 refers to the Trial Court's "decision" (singular) not "decisions" (plural) – *i.e.*, "[i]s the trial court's decision to defer ruling on the advancement of attorneys' fees supportable?" (emphasis added).

Complying with the express directive of this Supreme Court, as set forth in the Remand Order, was not an error by the Trial Court under any standard.

2. The Remand Decision Correctly Analyzed The Status Quo Ruling As An Exercise Of Discretion (Merritt OB 9-10)

The premise for Merritt's second argument is as follows:

Chancellor Glasscock found that after Chancellor Chandler granted R&R a *status quo* order, (1) the injunction-like standards governing motions to modify *status quo* orders applied to Merritt's requests for advancement instead of advancement concepts that have evolved over several decades; and (2) denials of motions to modify *status quo* orders are only reviewed for abuse of discretion instead of the de novo test applicable to denials of advancement. No reason exists for treating Merritt's requests in this fashion.

Merritt's argument is flawed in several respects. First, it ignores the fact that the Remand Order was limited to the Status Quo Ruling (as opposed to any other Trial Court rulings). Second, the argument ignores what, in fact, happened. The Trail

Court was not obligated on remand to pretend that Merritt filed some hypothetical motion that was never filed. Rather, the Trial Court properly considered the motion actually filed by Merritt's counsel – *i.e.*, a motion to modify the existing *status quo* order – which falls squarely within the Trial Court's discretion. *See, e.g.*, Remand Order ¶ 2 (quoting Status Quo Ruling: "THE COURT: Am I correct that there's also ... a motion filed and pending that requests that I modify the status quo order to allow advancement of fees to Ms. Merritt? ... 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."). Third, Merritt ignores the fact that her alleged right to advancement was disputed.⁴ That substantive dispute was deferred and, ultimately, never decided by the Trial Court (originally or on remand). Therefore, the question of whether Merritt was entitled under the LLC Agreements to advancement, as a matter of law, is not properly before this Court.

In sum, the Remand Decision properly analyzed the Status Quo Ruling for what it was – not what it hypothetically could have been had Merritt's counsel filed a different motion – under the well-settled standards applicable to such motions

⁴ As discussed at length in R&R's remand briefs and at oral argument, any contractual right to advancement Merritt had pursuant to Section 9.1 terminated as of August 20, 2008, by operation of the Section 4.5. *See* Exhibits B at 20-26, D at 3 (R&R remand briefs), F *passim* (remand oral argument transcript). Those arguments are incorporated herein by reference.

(i.e., a motion to modify an existing *status quo* order). The foregoing was not an error by the Trial Court under any standard.

3. The Remand Decision Properly Concluded That Chancellor Chandler Acted Within His Discretion When Entering The Status Quo Ruling (Merritt OB 10-15).

There was extensive discussion during oral argument concerning how to interpret the question presented in the Remand Order concerning whether the Status Quo Ruling "was supportable." Essentially, the Remand Order directed Vice Chancellor Glasscock to step into the shoes of Chancellor Chandler as of July 2009 and, in that context, decide if there was a defensible rationale for the Status Quo Ruling. As Vice Chancellor Glasscock stated in the Remand Decision:

To determine whether Chancellor Chandler's decision was "supportable," I must look to what was known to Chancellor Chandler at the time he made the decision to defer ruling on advancement, on July 10, 2009.

The Remand Decision also acknowledged the restriction contained in paragraph 7 of the Remand Order – i.e., "not to consider whether Merritt suffered any prejudice as a result of the Chancellor's decision not to award fees." Remand Decision at 21.

Pages 21-23 of the Remand Decision discussed Chancellor Chandler's authority to enter the *status quo* order, then notes that:

Once the *status quo* order is in place, the party seeking modification bears the burden of showing why it should be modified. The standard for whether a court has abused its discretion is the following:

Judicial discretion is the exercise of judgment directed by conscience and reason, and when a court has not exceeded the bounds of reason in view of the circumstances and has not so ignored recognized rules of law or practice so as to produce injustice, its legal discretion has not been abused.

Therefore, if the Chancellor's decision not to modify the *status quo* order did not exceed "the bounds of reason under the circumstances" and did not ignore "recognized rules of law or practice," then the Chancellor did not abuse his discretion.

Pages 24-29 of the Remand Decision contain the Trial Court's analysis based upon "what was known to Chancellor Chandler at the time he made" the Status Quo Ruling. That analysis cannot fairly be described as "exceed[ing] the bounds of reason in view of circumstances" or as "ignor[ing] recognized rules of law or practice so as to produce injustice."

Nevertheless, Merritt contends that the Status Quo Order was an abuse of discretion based upon her disagreement with the discussion on pages 25-26 of the Remand Decision regarding a May 2009 contempt motion related to her violations of the *status quo* order.⁵ Yet, no amount of spin by Merritt can change the Trial

⁵ Merritt again ignores the fact that the Remand Order was limited to the Status Quo Ruling and, instead, takes issue with the Trial Court's decision to enter the *status quo* order in August 2008, and the Trial Court's refusal to consider the substantive question of advancement after granting Merritt's motion to stay the Delaware proceedings. Because those issues fall

Court record summarized in the Remand Decision. And Merritt's attempts to dispute the conclusions drawn by Vice Chancellor Glasscock from that record do not come close to establishing that the Court's analysis exceeded the bounds of reason, or ignored rules of law (thereby creating injustice).

Merritt also claims (incorrectly) that the Remand Decision violated an alleged prohibition against "considering whether the decision to remove Merritt was correct," arguing that:

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

First, Merritt's above argument is based upon a mischaracterization of paragraph 7 of the Remand Order, which states:

In addressing this question, the trial court should not consider whether Merritt suffered any prejudice, either because the decision removing Merritt for cause was correct, or because the assistance of counsel could not have changed the result.

outside the scope of the Remand Order, R&R will simply note its disagreement and incorporate the briefing and argument on remand by reference. See note 5 above.

Second, Merritt's brief mischaracterizes the Remand Decision as asserting that Merritt's removal was correct. To the contrary, the Remand Decision refers to the PA Fraud Opinion and states:

This judgment provides substantial evidence that Merritt could not be trusted to safeguard the assets of her litigation adversary, R&R. Furthermore, Merritt knew, as of April 2009, that it was likely that this Court would find her "removed for cause" as Manager of the LLCs. Thus, Merritt had an incentive to transfer as many assets as possible from the LLCs to her personal accounts before such a determination.

The Remand Decision does not address "whether Merritt suffered any prejudice" from the Status Quo Ruling.

Although Merritt does not assert that the above Trial Court analysis exceeded the bounds of reason, she does assert that Vice Chancellor Glasscock violated "the principle proscribing consideration of the merits of the underlying case while deciding motions for advancement." Merritt OB 14-15. Yet, again, Merritt ignores the fact that the motion at issue in the Status Quo Ruling was a "renewed" motion by Merritt to modify the then-existing *status quo* order. It is well-settled Delaware law that the three-part test for temporary or preliminary injunctive relief (including a *status quo* order) involves an analysis of the merits (*e.g.*, either determining whether there is a colorable claim or a likelihood of success on the merits, depending upon the nature of the injunctive relief).

II. WHETHER MERRITT HAD A VALID RIGHT TO ADVANCEMENT IS NOT BEFORE THIS COURT (MERRITT OB 5-8)

As noted above, neither the Status Quo Ruling nor the Remand Decision decided 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, as acknowledged by the Remand Order, the effect of the Status Quo Ruling was to defer resolution of the advancement dispute. Therefore, the question of whether Merritt was entitled under the LLC Agreements to advancement, as a matter of law, is not properly before this Court. Nevertheless, even if it were, any contractual right to advancement Merritt had pursuant to Section 9.1 terminated as of August 20, 2008, by operation of the Section 4.5.⁶

CONCLUSION

For the foregoing reasons and those argued on remand below, R&R respectfully submits that the Status Quo Ruling was, in fact, supportable.

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⁶ See note 5 above.