EFiled: Sep 29 2020 05:00PM EDT
Transaction ID 65974918
Case No. 2020-0608-MTZ

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

HARLEY V. FRANCO,	:	
	:	
Plaintiff,	:	
	:	
v.	:	C.A. No. 2020-0608-MTZ
	:	
AVALON FREIGHT SERVICES LLC and DOUG HOUGHTON,	:	
	:	
Defendants.	:	

DEFENDANT DOUG HOUGHTON'S ANSWERING BRIEF IN OPPOSITION TO PLAINTIFF HARLEY V. FRANCO'S MOTION FOR SUMMARY JUDGMENT

HEYMAN ENERIO
GATTUSO & HIRZEL LLP
Kurt M. Heyman (# 3054)
Jamie L. Brown (# 5551)
300 Delaware Avenue, Suite 200
Wilmington, DE 19801
(302) 472-7300
Attorneys for Defendant Doug Houghton

Dated: September 29, 2020

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PRELIMINARY STATEMENT

Plaintiff Harley V. Franco ("Franco") has ***no authority or right*** to remove Defendant Doug Houghton ("Houghton") from his position as a Director on the Board of Directors of Avalon under either the Avalon Operating Agreement or the Delaware LLC Act, so he filed this action seeking this Court's assistance in removing him.[1] Franco's Opening Brief in Support of his Motion for Summary Judgment ("Franco's Opening Brief" or "FOB") offers no legal support for his position that this Court should sanction his attempt to unilaterally remove a Director—at whim and over the objection of the other appointing member—simply because of his recent "withdrawal of his approval for Houghton's continued service" on the Board. (FOB at 11). Rather, in the absence of a controlling operating agreement provision, under analogous Delaware corporate law made applicable to manager-managed LLCs, a majority of the designating members must agree to remove a currently sitting Director (as set forth more fully in Houghton's Opening Brief). For these reasons, the Court of Chancery should deny Franco's Motion for Summary Judgment (the "Summary Judgment Motion") and grant Houghton's

[1] Capitalized terms not defined herein have the meanings ascribed to them in the Opening Brief in Support of Defendant Doug Houghton's Motion to Dismiss the Verified Complaint ("Houghton's Opening Brief" or "HOB"). (Trans. ID No. 65909361).

Motion to Dismiss (the "Motion to Dismiss," and together with the Summary Judgment Motion, the "Motions").

STATEMENT OF FACTS

For purposes of Houghton's Motion to Dismiss, Houghton adopted the allegations in Franco's Verified Complaint as true, as he must under Rule 12(b)(6). Houghton is not so bound by those allegations in opposing Franco's Summary Judgment Motion.[2]

Nevertheless, there are only five facts necessary to the resolution of both Motions, none of which is disputed:

- Section 3.1 of the Avalon Operating Agreement governs the appointment and composition of its Board of Directors (Compl. ¶¶ 15-16; FOB at 2-3);
- Section 3.1 does not address removal of Directors (nor does any other provision of the Avalon Operating Agreement) (Compl. ¶ 2 (Avalon "operating agreement is silent as to a formal procedure for removing . . . the fifth board member"); FOB at 3 ("The Agreement has

[2] Franco's Opening Brief misstates the parties' discussion on the briefing for the Motions, asserting that "[t]he parties agree that no discovery is necessary to resolve this matter." (FOB at 1). Rather, Houghton has consistently taken the position that no discovery is needed to resolve Houghton's Motion to Dismiss. Houghton never agreed that no discovery would be needed to resolve Franco's Summary Judgment Motion, since Houghton's counsel had no idea whether the motion would reference facts outside the record. *See* Exhibits A, B.

no provision for the removal of any director, including the 5th Director.”));

- Houghton is a validly-appointed and currently serving Director of Avalon (Compl. ¶¶ 2, 6, 21);
- Bombard approves of Houghton and supports his continued service to the Board (Compl. ¶ 20); and
- Franco wants to remove and replace Houghton. (Compl. ¶ 21).

As set forth more fully below and in Houghton’s Opening Brief, based on the foregoing undisputed facts, Franco’s Summary Judgment Motion should be denied, and Houghton is entitled to judgment as a matter of law.

ARGUMENT

I. STANDARD ON THIS MOTION

Pursuant to Rule 56, “summary judgment will be entered only where the moving party demonstrates the absence of issues of material fact and that [he] is entitled to judgment as a matter of law.” *Wagamon v. Dolan,* 2012 WL 1388847, at *2 (Del. Ch. Apr. 20, 2012). “When the issue before the Court involves the interpretation of a contract, summary judgment is appropriate only if the contract question is unambiguous” and the moving party offers the only reasonable interpretation. *United Rentals, Inc. v. RAM Holdings, Inc.,* 937 A.2d 810, 830 (Del. Ch. 2007). “Ambiguity does not exist simply because the parties disagree about

what the contract means. . . . Rather, contracts are ambiguous 'when the provisions in controversy are reasonably or fairly susceptible of different interpretations or may have two or more different meanings.'" *Id*. (quotation omitted). Thus, "to succeed on [his] motion for summary judgment [Franco] must establish that [his] construction of the [Avalon Operating A]greement is the *only* reasonable interpretation." *Id.* (emphasis in original).

II. THE AVALON OPERATING AGREEMENT DOES NOT PERMIT UNILATERAL REMOVAL OF DIRECTORS

As set forth more fully in Houghton's Opening Brief, the Avalon Operating Agreement does not expressly address Director removal. (HOB at 5). Rather, it merely provides that "any vacancy in the fifth Board position may only be filled by the mutual[] agreement of Bombard and Franco." (*Id.*; Compl. ¶ 18). It is undisputed that Houghton currently serves as the fifth Director and no vacancy has occurred that would trigger the need for Bombard and Franco to mutually agree upon and appoint a replacement Director for the fifth Board position. (Compl. ¶¶ 2, 6 (reflecting service upon Houghton as a sitting manager); FOB at 5 (explaining that attempts to remove Houghton from his current position as the fifth director have failed); HOB at 5).

Notwithstanding the Avalon Operating Agreement's terms and lack of authorization for his desired course of action, Franco seeks to remove Houghton simply because he "does not agree that [he] should continue to serve" purportedly

"[f]or reasons unrelated to this action." (Compl. ¶ 21; FOB at 4; HOB at 9-15). Franco contends that his unilateral preferences to remove Houghton must be honored, despite acknowledging that he participated in selecting and appointing Houghton to be the "neutral tie-breaker," because he might "suddenly find himself as a minority voice," despite being a 50% owner, and "the context and purpose of the [Avalon Operating] Agreement . . . dictate that . . . Franco" must be "sufficiently protected from a majority block." (Compl. Ex. A § 3.1; FOB at 7-8).

To avoid finding himself on the losing end of any future Board-action, Franco contends this Court should construe the Avalon Operating Agreement to permit either faction who participated in appointing the fifth "neutral tie-breaker" Director to "withdraw[] his approval for Houghton" and force a unilateral removal. (FOB at 7, 11). Franco's "continuous approval" condition on the fifth Board seat runs contrary to the plain language of the Avalon Operating Agreement and would disenfranchise Bombard and Houghton following the initial joint-selection process set forth in the Avalon Operating Agreement. *See Investment Assocs., Inc. v. Standard Power & Light Corp.,* 29 Del. Ch. 225, 234 (Del. Ch. 1946) ("In theory at least, the corporate enterprise is to be operated along democratic lines, and whenever a point of construction arises it seems to me it should be decided in favor of the accepted democratic procedure, unless explicit language requires a different conclusion"); *In re Explorer Pipeline Co.,* 781 A.2d 705, 714 (Del. Ch. 2001) ("the

democratic majority . . . generally controls" and any provision "at odds with the 'fundamental principles of majority rule,' must be 'clear and unambiguous.'") (quotation omitted).

Houghton argues that in the absence of an express removal provision, it would be inconsistent with the 50-50 governance scheme contemplated by the Avalon Operating Agreement to permit unilateral action by one of the designating factions to remove the person intended to serve as a neutral tie-breaker. (HOB at 11-12). Houghton further argues that under Court-sanctioned analogy to corporate law, Section 141(k) of the DGCL yields the same result he urges, as it requires a majority of the designating stakeholders to remove a director. (HOB at 12-15) (citing *Obeid v. Hogan,* 2016 WL 3356851, at *6 (Del. Ch. June 10, 2016)).

III. FRANCO'S "CONTINUOUS APPROVAL" INTERPRETATION OF SECTION 3.1 OF THE AVALON OPERATING AGREEMENT IS UNREASONABLE, IMPRACTICAL AND DISTORTS PLAIN LANGUAGE

A. Franco's Interpretation of Section 3.1 Tortures its Plain Language

Franco contends that Section 3.1's provision that the fifth Director be "mutually agreed upon and appointed" means "the mutuality requirement applies not just to the initial appointment of the 5th Director (Houghton), but also to his continued service as a board member." (FOB at 7). In so contending, Franco necessarily argues that the ***only*** reasonable interpretation of "mutually agreed upon and appointed" means that the fifth Director must be vetted by both appointing

factions not only at the outset of his or her appointment, but also ***each and every day and every Board decision thereafter***, or—as Franco puts it, "throughout the duration of his or her service,"—because any other "interpretation would violate the rules on contract construction by rendering the 'agreed upon and' verbiage superfluous and utterly without meaning." (FOB at 8, 9). Franco contends that, if continuous agreement is not required, the words "agreed upon and" would be unnecessary verbiage and should have been omitted from Section 3.1 of the Avalon Operating Agreement, as it would have been sufficient to simply say that the fifth director must be "mutually . . . appointed." (FOB 9).

Franco's interpretation is as wrong as it is unworkable and must be rejected as unreasonable as a matter of law. *See O'Brien v. Progressive N. Ins. Co.,* 785 A.2d 281, 288 (Del. 2001) ("a contract is only ambiguous when the provisions in controversy are ***reasonably*** or ***fairly*** susceptible to different interpretations or may have two or more different meanings") (emphasis added); *Axis Reinsurance Co. v. HLTH Corp.,* 993 A.2d 1057, 1063 (Del. 2010) ("a court will not adopt [an] interpretation that leads to unreasonable results, but instead will adopt the construction that is reasonable"); *Osborn v. Kemp,* 991 A.2d 1153, 1160 (Del. 2010) ("An unreasonable interpretation produces an absurd result."); *Lorillard Tobacco Co. v. Am. Legacy Found.,* 903 A.2d 728, 740 (Del. 2006) ("A court must accept and apply the plain meaning of an unambiguous term in the context of the contract

language and circumstances, insofar as the parties themselves would have agreed *ex ante*"); *Pharm. Prod. Dev., Inc. v. TVM Life Science Ventures VI, L.P.,* 2011 WL 549163, at *4 n.24 (Del. Ch. Feb. 16, 2011) ("contracts must be construed with business sense").

First, the requirement that the "fifth (5th) director shall be mutually agreed upon and appointed by Bombard and Franco" has one clear plain-language meaning that gives effect to each and every word: Franco and Bombard must first agree upon ***who*** the fifth director should be, ***and then***, together, appoint that individual to Avalon's Board. Contrary to Franco's arguments, this interpretation does not render any language superfluous or without meaning—there can be no mutual appointment without the antecedent mutual agreement between Bombard and Franco as to who the appointee should be. Indeed, the mutuality modifier applies to ***both*** the agreement on the candidate and the execution of the formal mechanisms of appointment that follow—events that each occur but once, and both prior to the Director's service. *See Allied Cap. Corp. v. CG-Sun Holdings, L.P.,* 910 A.2d 1020, 1030 (Del. Ch. 2006) ("When the language of a contract is plain and unambiguous, binding effect should be given to its evident meaning"); *Rhone-Poulenc Basic Chems. Co. v. Am. Motorists Ins. Co.,* 616 A.2d 1192, 1196 (Del. 1992) ("Courts will not torture contractual terms to impart ambiguity where ordinary meaning leaves no room for uncertainty" and "[a]mbiguity does not exist where the court can

determine the meaning of a contract 'without any other guide than a knowledge of the simple facts on which, from the nature of language in general, its meaning depends.") (citation omitted).[3]

Second, Franco's construction—requiring continually renewed agreement—also ignores important temporal signals in Section 3.1 that run contrary to his favored interpretation. The mutual agreement as to the fifth director is an event that occurs ***just one time***, and is not an ongoing or forward-looking event: "The fifth (5th) director shall be mutually agree***d*** upon and appoint***ed*** by Bombard and Franco." (Compl. Ex. A § 3.1) (emphasis added). This phrase contemplates one agreement on the fifth director, which precedes his appointment, and makes no reference to future or ongoing agreements regarding the continued service of fifth director.

The parties could have easily drafted a provision requiring periodic assessments of the fifth director's mutual acceptability—or even annual

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[3] Even if the mutuality modifier could be construed as redundant (it is not), such an interpretation does nothing to disturb the single objective meaning of the phrase "mutually agreed upon and appointed." *See In re IAC/InterActive Corp.,* 948 A.2d 471, 498, *id.* n.109 (Del. Ch. Mar. 28, 2008) (even slightly redundant interpretations are acceptable, and indeed preferable, to interpretations that would require the Court to give words meaning they were not intended to have); *see also iBio, Inc. v. Fraunhofer USA, Inc.,* 2016 WL 4059257, at *11 (Del. Ch. July 29, 2016) (even language that is "somewhat redundant" is not necessarily superfluous). And "courts will not bend contract language to read meaning into the words that the parties obviously did not intend." *Majkowski v. Am. Imaging Mgmt. Servs., LLC,* 913 A.2d 572, 588 (Del. Ch. 2006). Rather, "courts are required to give unambiguous contract terms their plain meaning." *ITG Brands, LLC v. Reynolds Am., Inc.,* 2017 WL 5903355, at *6 (Del. Ch. Nov. 30, 2017).

re-election—should they have wanted or intended the opportunity to re-evaluate their mutual agreement, but they did not. *See PPL Corp. v. Riverstone Holdings LLC,* 2019 WL 5423306, at *11 (Del. Ch. Oct. 23, 2019) ("Had the parties intended to impose that obligation . . . they would have said so."); *DeLucca v. KKAT Mgmt., L.L.C.*, 2006 WL 224058, at *2 (Del. Ch. Jan. 23, 2006) ("[I]t is not the job of a court to relieve sophisticated parties of the burdens of contracts they wish they had drafted differently but in fact did not. Rather, it is the court's job to enforce the clear terms of contracts."); *Allied Cap.*, 910 A.2d at 1033 ("[C]ourts will not rewrite contractual language . . . just because one party failed to extract as complete a range of protections as it, after the fact, claims to have desired"). And in fact, this Court should be wary of extending unambiguous language "when the contract could easily have been drafted to expressly provide for" the language Franco now urges, but declined to do so, because "creating an ambiguity where none exists could, in effect, create a new contract with rights, liabilities and duties to which the parties had not assented." *Allied Cap.,* 910 A.2d at 1035; *Rhone-Poulenc,* 616 A.2d at 1196.

B. Franco's Interpretation Yields Unreasonable Results: A Neutral Tie-Breaker Cannot Fulfill His Function if he Must Continually Satisfy Both Factions

Franco contends that mutual agreement between himself and Bombard as to Houghton's acceptability must be maintained at all times, or else, either Franco or Bombard would be entitled to withdraw their support of Houghton and force a

removal/vacancy and replacement of the fifth director seat. (FOB at 7-10). Stated another way, Franco's position requires that the fifth director remain—at all times—beholden to ***both*** factions, despite conceding that the fifth director seat was intended to be a tie-breaker. (FOB 7-8) ("the 5th Director serving as a mutually agreed upon neutral tie-breaker"). But Franco's propositions cannot be logically or practically reconciled and are inconsistent with Delaware law.

As a practical matter, Franco's position means that the fifth director could only break a tie ***once*** before being deposed, because one cannot remain simultaneously beholden to two split factions and fulfill a tie-breaking role. After all, breaking a tie necessarily involves offending one faction or the other, which would likely trigger a "withdraw[al of] the necessary consent for the 5th Director's continuing seat." (FOB at 11; *see id.* at 10 (arguing that "continued mutual consent for the 5th Director beyond appointment" is accompanied by an "inherent" "power to remove" the offending director)). Directorships and the persons who fulfill them are not intended to be disposable or single-use under Delaware law. Moreover, Directors are intended to exercise their own, independent, good faith business judgment, and must not be continually beholden to their designating stakeholders as Franco would suggest. *See In re MFW S'holders Lit.,* 67 A.3d 496, 509 (Del. Ch. 2013) (noting a director's discretion is sterilized when beholden to their controlling party or under their influence).

C. Franco's Purported Concern of "Undue Alignment" is Mitigated at the Time of Appointment and by Fiduciary Duties

Franco also urges the Court to find an "inherent" unilateral right of removal by arguing that, in the absence of such a removal right, minority oppression might result. (FOB at 8). But the requirement that the fifth director be "mutually agreed upon" ***prior to*** appointment serves as Franco and Bombard's safeguard against the "neutral tie-breaker" becoming "unduly aligned with one side." (FOB at 8). Presumably, each of Franco and Bombard would only agree to a director that they believed possessed the good judgment to serve the best interests of the limited liability company at all times and would reject any candidate that possessed leanings in favor of one faction or the other. This joint participation at the appointment stage, therefore, serves an important gatekeeping function.

Moreover, Franco is not at risk of abuse if he "suddenly find[s] himself as a minority voice" as to a Board vote. (FOB at 8). Indeed, Houghton's fiduciary duties to Avalon (and GH Channel as its sole member) always require that he act in the best interests of the limited liability company as a whole. "[M]anagers of a Delaware limited liability company owe traditional fiduciary duties of loyalty and care to the members of the LLC, unless the parties expressly modify or eliminate those duties in the operating agreement." *William Penn Partnership v. Saliba,* 13 A.2d 749, 756 (Del. 2011) (citing *Bay Center Apts. Owner, LLC v. Emery Bay PKI, LLC,* 2009 WL 1124451, at *8 (Del. Ch. Apr. 20, 2009)). These traditional

fiduciaries provide Franco with a remedy if he believes Houghton has "become unduly aligned" with Bombard and formed "a majority block" that operates to the detriment of Avalon or GH Channel.[4] Otherwise, if Houghton votes in good faith and adheres to his fiduciary duties and Franco winds up on the losing end of a Board vote, the outcome is nothing more than the product of democratic decision-making, wherein Franco failed to prevail, a result entirely consistent with Delaware law.

Finally, if the parties believed *ex ante* there was a risk that the fifth director could become unduly beholden to one faction or the other, the parties would have drafted the Avalon Operating Agreement to include provisions that specifically governed the "Relative rights, powers and duties" as to a the fifth Director (as contemplated by 6 *Del. C.* § 18-404) or imposed supermajority voting requirements as to certain matters. They did not. Franco's argument is a *post hoc* attempt to justify removing Houghton.

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[4] Franco has not, and cannot allege, that Houghton has acted in any way contrary to his fiduciary duties or that Franco has any reason to believe that he has or will "become unduly aligned with one side (Franco or Bombard)," in a way that has or will taint his decision-making or cause him to disregard his fiduciary duties and harm Avalon or its Member. Indeed, Franco's hypothetical parade of horribles is nothing more than Franco's speculation that he ***could***—at some point in the future—be outnumbered in unknown Board decisions, which he believes could become a personal "los[s of] all control over the management of [Avalon]." (FOB at 8). But Delaware law requires any purported disqualifying ties to be actual and material—not hypothetical—before serving as the basis to support allegations of breaches of fiduciary duties or tainted decision-making that affects the impartiality of a director. *See MFW,* 67 A.3d at 509-510.

D. The Board is not Powerless to Remove Houghton

Franco contends that the absence of an express removal provision weighs against Houghton's proffered interpretation because the Avalon Operating Agreement would otherwise "result in Houghton being awarded a perpetual membership on the Board" and leave Avalon's sole Member, GH Channel, "powerless to remove him, ever." (FOB at 10). But Houghton's Opening Brief addresses Director removal where both the Avalon Operating Agreement and the LLC Act are silent, positing that "Bombard and Franco could presumably create a 'vacancy' in the fifth Board seat by mutually agreeing to remove Houghton (whether by voting or by amendment to the Operating Agreement), and then could jointly vote to fill that vacancy." (*See* HOB at 10 n.4; 12-15).[5] As set forth in Houghton's Opening Brief, analogy to Section 141(k) of the DGCL supports this analysis. (HOB 14-15). *See also Obeid v. Hogan,* 2016 WL 3356851, at *6 (Del. Ch. June 10, 2016) (applying 8 *Del. C.* § 141(k) to removal of a manager of a manager-managed limited liability company).

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[5] Commentators who have addressed this situation—where an operating agreement omits a removal mechanism and where 6 *Del. C*. § 18-402 provides no default provision—agree that an amendment to the operating agreement would be the preferred means of removal. *See* Robert L. Symonds, Jr. & Matthew J. O'Toole, *Symonds & O'Toole on Delaware Limited Liability Companies* § 9.05[C], at 9-53 to -54 (2d ed. & Supp. 2018); *see also Llamas v. Titus,* 2019 WL 2505374, at *16 (Del. Ch. June 18, 2019) ("These scholars suggest that an amendment to the LLC operating agreement would be required to effectuate removal.") (citing the same). Thus, if Franco wants to remove Houghton or to add a removal mechanism

CONCLUSION

For the foregoing reasons and those stated in Houghton's Opening Brief, Franco's Motion for Summary Judgment should be denied, as Houghton's interpretation of the interpretation of the plain and unambiguous language of the Avalon Operating Agreement is the only reasonable one.

HEYMAN ENERIO
GATTUSO & HIRZEL LLP

/s/ Jamie L. Brown
Kurt M. Heyman (# 3054)
Jamie L. Brown (# 5551)
300 Delaware Avenue, Suite 200
Wilmington, DE 19801
(302) 472-7300
Words: 3,611

Attorneys for Defendant Doug Houghton

Dated: September 29, 2020

to the Avalon Operating Agreement, an amendment would be required, which would require Bombard's consent. (Compl. ¶¶ 20-21).

CERTIFICATE OF SERVICE

I, Jamie L. Brown, hereby certify that on September 29, 2020, copies of the foregoing Answering Brief in Opposition to Plaintiff Harley V. Franco's Motion for Summary Judgment were served electronically upon the following counsel:

Michael J. Joyce, Esquire
THE LAW OFFICES OF JOYCE, LLC
1225 King Street, Suite 800
Wilmington, DE 19801

/s/ Jamie L. Brown
Jamie L. Brown (# 5551)