

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

THE HOMER C. GUTCHESS 1998 :
IRREVOCABLE TRUST, :
 :
Petitioner, :
 :
vs. : Civil Action
 : No. 4916-VCN
GUTCHESS COMPANIES, LLC, :
 :
Respondent. :

- - -

Chancery Court
38 The Green
Dover, Delaware
Tuesday, February 16, 2010
2:05 p.m.

- - -

BEFORE: HON. JOHN W. NOBLE, VICE CHANCELLOR.

- - -

ORAL ARGUMENT
RESPONDENT'S MOTION TO DISMISS

- - -

CHANCERY COURT REPORTERS
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Dover, Delaware 19901
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1 APPEARANCES:

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EDMOND D. JOHNSON, ESQ.
Pepper Hamilton LLP
for Petitioner

KURT M. HEYMAN, ESQ.
Proctor Heyman LLP
-and-

LUCY PRASHKER, ESQ.
of the Massachusetts bar
Cain, Hibbard & Myers PC
for Respondent

- - -

1 THE COURT: Good afternoon, everyone.
2 Mr. Heyman, this is your motion to
3 dismiss.

4 MR. HEYMAN: Yes, Your Honor. I am
5 here on behalf of respondent. I rise to make an
6 introduction of Lucy Prashker, my co-counsel from Cain
7 Hibbard & Myers in western Massachusetts. I think we
8 may have their winter this year, Your Honor, and if
9 you want to order them to take it back, I certainly
10 won't object to that.

11 With no further adieu, Lucy Prashker.

12 THE COURT: Good afternoon, and
13 welcome.

14 MS. PRASHKER: Good afternoon, and
15 thank you for hearing us this afternoon. We are
16 jealous of all this white stuff. We have very little
17 of it up north.

18 THE COURT: As Mr. Heyman suggested,
19 if you want to take with you, you are more than
20 welcome. I'll give you my home address and you can
21 pull it off my unshoveled sidewalks.

22 MS. PRASHKER: We represent Gutchess
23 Companies LLC, and that's a Delaware LLC that was
24 formed in 2002 by Homer Gutchess who owned a large and

1 successful lumber company in upstate New York, a
2 lumber company that continues to operate today, and
3 employs upward of 300 people in upstate New York.

4 The LLC was formed as part of a
5 comprehensive estate planning program, and as stated
6 in the operating agreement itself, the initial purpose
7 of the LLC was to hold the Gutches lumber company
8 stock, the operating company's stock.

9 The purpose clause of the operating
10 agreement is very broad, however, and it recites that
11 the LLC can operate for any lawful purpose, including,
12 without limitation, holding that lumber's stock and
13 doing things to increase the value of the underlying
14 assets.

15 As is common in estate planning, Homer
16 Gutches, when he formed this LLC, decided to split
17 the voting interests in the LLC from the equity
18 interest, and if you look at schedule one to the
19 original iteration of the operating agreement, you see
20 that Homer Gutches retained 100 percent of the voting
21 interest in the LLC; only 1 percent of the economic
22 interest, but 100 percent of the voting interest.

23 His wife had 1 percent of the economic
24 interest, no voting rights. And the trust, a

1 pre-existing trust that, again, Homer Gutchess had
2 established as part of his estate planning program,
3 held 98 percent of the economic interest, no voting
4 interest.

5 So Homer controlled 100 percent of the
6 voting interests of the LLC when the LLC was
7 established in 2002.

8 A couple of years later, on the advice
9 of his counsel, he determined to transfer his voting
10 interest in the LLC to his wife, Martha Gutchess, and
11 I'll get into the specifics of that transfer a bit
12 later. But following that transfer, you had Martha
13 Gutchess owning 100 percent of the voting interest,
14 Martha Gutchess also owning 2 percent of the economic
15 interest in the LLC, and again, the 1998 irrevocable
16 trust continued to hold 98 percent of the economic
17 interest with no voting rights, no right of control.

18 Now, the current trustees of the 1998
19 irrevocable trust, who are not the original trustees,
20 are Mr. Ames and Mr. Keith Gutchess. Mr. Keith
21 Gutchess is a brother of Homer Gutchess. Mr. Homer
22 Gutchess died in 2006.

23 So the current trustees have, in this
24 proceeding, moved for dissolution of the LLC, judicial

1 dissolution. We have moved to dismiss on the ground
2 that the petition fails to allege facts that would
3 justify judicial dissolution of this LLC. The law, as
4 Your Honor knows, views judicial dissolution as an
5 extreme remedy to be sparingly exercised, and only
6 when it is not reasonably practicable for the LLC to
7 continue operations in accordance with the purpose
8 clause of its operating agreement. And, again, the
9 purpose clause of this operating agreement is very
10 broad, and includes operations for any lawful purpose.

11 In this case, there is no allegation
12 in the petition of any voting deadlock. Indeed, under
13 this structure, it's impossible to have deadlock
14 because Homer kept 100 percent of the voting interest
15 in a single person; first himself and then Martha. So
16 it's impossible to have voter deadlock in this case.

17 There is no allegation in the petition
18 of any financial insolvency of the LLC. The LLC is
19 solvent and is operating. There is no allegation that
20 the LLC is dormant or is in a state of inertia.
21 Indeed, the complaint is that the LLC is doing too
22 much rather than too little. The complaint is that
23 the current trustees don't like the current manager of
24 the LLC.

1 The current manager is Gary Gutchess,
2 the only son of Homer and Martha Gutchess, and he is
3 currently the manager of the LLC and making management
4 decisions with which the trustees, the current
5 trustees, disagree.

6 THE COURT: Well, you indicated that
7 the formation of the LLC was part and parcel of a
8 sophisticated estate planning effort that spanned
9 several years. I look at the purpose set forth in the
10 LLC agreement, but when I back up and look at the
11 trust agreement and the sequence of events and the
12 unhappy relationship that Mr. Gutchess had with his
13 son, I come away disturbed and concerned that what
14 really is going on here is not what Mr. Gutchess
15 intended, because things are not being run as I would
16 think he intended, given what I draw from the overall
17 allegations in the amended petition.

18 MS. PRASHKER: Well, as a factual
19 matter, we disagree with that. We believe that
20 Mr. Gutchess, Mr. Homer Gutchess, who reconciled with
21 his son before his death, and in fact, as the
22 petitioners themselves concede in the petition, left
23 his son an inheritance. We disagree that things are
24 being run at the LLC level contrary to the intentions

1 of Homer Gutchess. But in terms of the law --

2 THE COURT: My understanding though
3 was that as of -- and maybe I missed the facts here,
4 as of the time the LLC agreement was drafted, they
5 were still estranged. Is that correct?

6 MS. PRASHKER: In 2002, Gary Gutchess
7 was not working at Gutchess lumber company, and I
8 would say their relationship was strained. That is
9 correct.

10 But the LLC -- the intent of the
11 parties to the operating agreement has to be gleaned
12 from the purpose clause. It's not appropriate, when
13 you have an agreement that is unambiguous on its face
14 as to its purpose, and the purpose is broad, that it's
15 inappropriate in that circumstance for the Court to
16 try to glean the subjective intent of the parties to
17 that agreement when there is no ambiguity in the
18 contract itself.

19 That's the beauty of an LLC; is that
20 it's a contract, and sophisticated parties are bound
21 by the terms of the contract, and the intent has to be
22 gleaned from the language of the operating agreement
23 itself.

24 I think the case law is pretty clear

1 on that, because if every time an LLC were formed
2 where there's a split between the voting rights and
3 the equity rights, the parties to that agreement are
4 going to be uncertain as to whether a Court, eight
5 years later, can going to try to reconstruct the
6 intent of the parties back in 2002 when the LLC was
7 formed.

8 There's going to be no certainty of
9 contract. There is going to be no certainty that what
10 you are intending to put together here and what you
11 express in words as to your intent, is going to be
12 upheld and enforced by the courts.

13 I think that's a very serious
14 circumstance to have a situation where you don't know
15 whether, in eight years, or ten years, or 12 years,
16 the Court is going to second guess the intent, and as
17 you describe it in the operating agreement and look
18 for some other intent or purpose, look for some intent
19 that your only son never be permitted to be the
20 manager of that LLC.

21 If that was really what was driving
22 Mr. Gutchess' actions in 2002, it would have been very
23 simple for him to include in the operating agreement a
24 provision that says, "The manager shall be appointed

1 by 75 percent of the voting interest except in no
2 event shall the manager be my son, Gary Gutchess." He
3 didn't do that. And that wasn't his intent.

4 So, in terms of looking at what the
5 law is on judicial dissolution, the traditional things
6 you look for are, number one, voting deadlock. Not
7 alleged here. Not possible to be alleged here,
8 because 100 percent of the voting interest resides in
9 Homer Gutchess's wife, Martha Gutchess.

10 By the way, Your Honor, in terms of
11 Homer Gutchess' original intent, there is no
12 allegation, and there can be no allegation that Homer
13 Gutchess never intended for Martha Gutchess to have
14 control of that voting interest. That's who controls
15 the voting interest right now. Not Gary Gutchess.
16 Martha Gutchess. She controls the voting interest,
17 and what the petitioners seek is to wrest away from
18 Homer's widow, Martha Gutchess, the voting control
19 over the LLC.

20 Gary Gutchess is a little bit of a red
21 herring here because, yes, Martha Gutchess has
22 appointed him as manager, but it's really Martha
23 Gutchess who owns that voting interest; not Gary
24 Gutchess, and it's Martha Gutchess' control of that

1 voting interest that the trustees are unhappy with.

2 And they, therefore, ask the Court to
3 ignore the operating agreement, to ignore the split of
4 voting interest from equity interest, collapse the LLC
5 structure, and grab control of the underlying
6 operating company away from Martha Gutches, away from
7 Homer Gutches' widow. And no one has alleged, and no
8 one can allege, that Homer Gutches didn't intend
9 Martha Gutches to have control of that voting
10 interest.

11 There is not a single case in Delaware
12 that has ordered judicial dissolution under these
13 circumstances, and in all of the reported decisions
14 where an LLC has been dissolved by the Court, there
15 has been voting deadlock and/or financial insolvency
16 or organizational inertia or stalemate. And none of
17 those things are present here.

18 So if the Court is going to allow this
19 kind of proceeding to move forward in the absence of
20 allegation of voting deadlock or financial insolvency
21 or any other circumstance that makes it reasonably
22 impracticable for the LLC to continue to operate in
23 accordance with the terms of the operating agreement,
24 the Court would be making new law.

1 And I would submit that that new law
2 would be inconsistent with the most fundamental
3 principle behind LLC law, which is freedom of contract
4 and honoring the terms of an unambiguous agreement, as
5 this operating agreement is.

6 In terms of one other point, if I
7 might, on Homer Gutchess' intent, whether these
8 trustees are accurately portraying Homer's intent, and
9 whether they, in fact, are operating in accordance
10 with Homer's intent is being litigated up in
11 Surrogates Court in New York State.

12 Martha Gutchess, who is a primary
13 beneficiary under the trust -- petitioners would like
14 the Court to sort of avoid that fact, and they
15 describe her as only minimally a beneficiary, but in
16 fact, if you read the trust, she's a primary
17 beneficiary. She's the first one named.

18 Martha Gutchess, Gary Gutchess and
19 Martha Gutchess' two grandsons, Matthew and Daniel
20 Gutchess, have petitioned the Surrogates Court in New
21 York to remove these trustees as trustees of the 1998
22 irrevocable trust because they, it is alleged, have
23 breached their fiduciary obligations to the
24 beneficiaries, including Martha Gutchess.

1 That's being litigated up in New York
2 whether these trustees are acting in concert, in
3 compliance, in a way consistent with the terms of the
4 trust and Homer's original intent. So that is an
5 issue that is getting addressed up there where it
6 should be in Surrogates Court.

7 It's not the issue before this Court
8 on a petition for judicial dissolution where you
9 should be looking at the operating agreement and the
10 purpose clause in that operating agreement.

11 The case that we think is the most
12 similar to this case in terms of the facts alleged,
13 and why we think it appropriate that a motion to
14 dismiss be granted at this stage, is the Seneca case,
15 Seneca Investments case, which is a relatively recent
16 case out of the Court of Chancery where the case was
17 actually stronger for judicial dissolution than this
18 case, because in Seneca, you didn't have voter
19 deadlock.

20 We don't have voter deadlock here, but
21 in Seneca, you had really a moribund LLC. There
22 wasn't even a manager of the LLC and nothing was
23 happening in the LLC, and there were violations of the
24 operating agreement going on because distributions

1 weren't being made, and reports weren't being
2 generated, and there were other problems.

3 So one of the members moved for
4 judicial dissolution in that case, and the Court said,
5 no, we're not going to use the extreme remedy of
6 judicial dissolution to police violations of the
7 operating agreement. If you want to sue for breach of
8 the operating agreement, do that. But that doesn't
9 justify a breach of the operating agreement -- does
10 not justify the extreme remedy of judicial
11 dissolution.

12 Here, we actually have an active LLC.
13 There's no allegation that there's any kind of
14 management dysfunction. We have all of the voting
15 interests residing in a single person. We have a
16 single manager, and that manager is making decisions.

17 The complaint is that the decisions
18 are not to the liking of the trustees. The complaint
19 is that he hasn't given them information that they
20 wanted, or he hasn't made distributions that they
21 wanted, or he's changed the operating agreement with
22 the consent of Martha Gutches to provide that he can
23 be compensated for the work that he does.

24 Those are the complaints. Well, the

1 remedy for those kinds of complaints is not judicial
2 dissolution. If they really believed that this was a
3 breach of fiduciary duty or a violation of an
4 operating agreement, they would have sued for that.
5 But they haven't included a count for breach of
6 fiduciary duty or for breach of the operating
7 agreement in their petition. The only remedy they
8 seek is the extreme remedy of judicial dissolution.

9 I'd like to take a couple of minutes,
10 if I might, to address the new argument that was made
11 in the opposition papers that the transfer of voting
12 rights by Homer Gutches to Martha Gutches in 2004
13 was somehow ineffective.

14 This is not an argument -- this is not
15 an allegation that was made in the amended petition.
16 There is no allegation in the amended petition that
17 the transfer of those voting rights was ineffective
18 because, as they now argue, Homer Gutches had nothing
19 to transfer when he made that transfer to Martha
20 because he had already transferred something to the
21 voting trust.

22 All that is in the amended petition
23 are a couple of inserts of the word "purported" when
24 there's a description of Homer's transfer of the

1 rights to Martha. I think it reads "Homer's purported
2 transfer of the rights to Martha."

3 And then Martha's termination of the
4 voting trust, they refer to that termination as a
5 "purported termination." But there is no following-
6 along allegation that, in fact, the transfer by Homer
7 Gutches to Martha Gutches was ineffective. You will
8 not find that anywhere in the petition. And there is
9 no allegation that it was ineffective because Homer
10 had already transferred those voting rights to the
11 voting trust.

12 If, in fact, that's true though, if,
13 in fact, Homer Gutches had nothing to transfer in
14 2004 when he transferred these voting rights to Martha
15 Gutches, and Martha Gutches, therefore, had no power
16 to terminate the voting trust, then the remedy is a
17 declaratory judgment that the voting trust still has
18 control, because all those things that happened didn't
19 really happen, they were all ineffective.

20 So the voting trust still has control,
21 so the voting trustees who are different from these
22 two trustees, by the way, the voting trustees should
23 have control of the LLC and has nothing to do with
24 judicial dissolution of the LLC.

1 There's no need for judicial
2 dissolution of the LLC under that circumstance because
3 the control would just revert back to the trustees of
4 the voting trust. But they're not seeking that. They
5 don't want that. They want to blow up the LLC.
6 That's the only thing that will satisfy these
7 trustees, and they want to blow up the LLC because
8 they're unhappy that their economic interest has been
9 split from the voting interest.

10 And that was a decision that was made
11 in 2002 by Homer Gutchess. It's something that's
12 permitted under the Delaware Limited Liability Company
13 Act, specifically allowed, a division of voting
14 interest from economic interest. It was part of the
15 estate plan, and it shouldn't be eviscerated by these
16 two trustees because they want to wrest control of
17 that lumber company away from Homer's widow, Martha
18 Gutchess.

19 On the transfer of voting rights, if
20 the Court wants to look at that issue, even though
21 it's not alleged in the amended petition, but if the
22 Court wants to look at that issue, we have attached to
23 our reply papers the documents that are referenced in
24 the amended petition that relate to those allegations.

1 So there is a reference in the amended
2 petition to the voting trust. We have attached the
3 voting trust to our supplemental transmittal
4 affidavit. I think that's Exhibit D. There is a
5 reference in the amended petition to the trust
6 certificate, I think it's called the Voting Trust
7 Certificate, that was issued to Homer Gutchess when he
8 delivered to the voting trust the voting interest in
9 the LLC.

10 What he got back was the certificate,
11 and under the terms of the voting trust agreement,
12 that certificate is transferable. The voting trust
13 says that specifically. The voting trust certificate
14 is transferable. And we have attached the voting
15 trust certificate itself, and that certificate also
16 recites that it is a transferable instrument.

17 And that's what happened. We have
18 attached the assignment that Homer Gutchess executed
19 that operated to transfer that trust certificate from
20 him to Martha, and under the terms of the voting trust
21 agreement itself, that effected a transfer of that
22 voting interest subject to the terms of the voting
23 trust, and Martha then, as a member under the voting
24 trust agreement, had the right to terminate that

1 voting trust at any time.

2 All of these questions are issues of
3 law to be determined by viewing the unambiguous
4 language of the voting trust agreement, the voting
5 trust certificate and the assignment. There are no
6 factual issues there for the Court to resolve through
7 trial.

8 But, again, I don't even think the
9 Court need go there because it really has nothing at
10 all to do with dissolution. If they're right that
11 that transfer was somehow ineffective, there would be
12 no need for judicial dissolution because control would
13 revert back to those voting trustees.

14 So, in sum, unless the Court has
15 additional questions for me at this point, it's our
16 position that the petition fails to allege facts that
17 would support the extraordinary remedy of judicial
18 dissolution here.

19 There is no allegation of voter
20 deadlock. There's no allegation of financial
21 insolvency. There's no allegation that the LLC is
22 unable to operate in accordance with the purpose
23 clause of the operating agreement. So judicial
24 dissolution is inappropriate here. We, therefore, ask

1 that the petition be dismissed.

2 THE COURT: Thank you.

3 MR. JOHNSON: Good afternoon, Your
4 Honor.

5 THE COURT: Good afternoon.

6 MR. JOHNSON: Edmond Johnson on behalf
7 of the petitioners. I think it's important to
8 remember in this case that the petition supported its
9 claim for relief with at least eight factual
10 assertions: First, that the current management has
11 purposely run the Gutchess LLC in a manner designed to
12 create tax liability for the trust. It's a 98 percent
13 equity holder.

14 Second, that current management has
15 purposely stopped GLC, which is the lumber company,
16 from buying timber from GTP which is the timber
17 management company so that the trust would be starved
18 for income with which it could pay the tax liabilities
19 created by the LLC.

20 Third, that current management has
21 sued to stop GTP, which was the timber management
22 company, from selling timber to anyone else so that
23 the trust would be starved for income from which it
24 could pay the tax liabilities created by the LLC, and

1 also its own not inconsiderable tax liabilities on the
2 timber lands that it owns which it has to pay every
3 year.

4 The trust also, fourth in the
5 petition, it alleges that certain adverse market
6 conditions make it unlikely that the Gutchess LLC will
7 make distributions to the trust sufficient to pay the
8 tax expense that the LLC has created in the
9 foreseeable future.

10 Fifth, that current management of the
11 LLC has refused to provide the trust with certain
12 information, corporate information that it needs to
13 fulfill its duties to the lenders and is information
14 that the manager was required to provide to the
15 members.

16 Sixth, that current management of the
17 LLC has taken steps to enable it to refuse to provide
18 corporate information to the trust in the future; that
19 current management of the LLC has destroyed the
20 diversification of the trust assets by making it
21 totally dependent on the lumber business.

22 Eighth, that all of these actions were
23 taken purposefully to harm the trust.

24 Ninth, that the actions of current

1 management have been intended to and have all but
2 destroyed the value of the trust's interests in the
3 LLC because the trust interest is only an equity
4 interest, and the person who asserts the right to
5 choose management is working in concert with current
6 management to decrease the value of the trust interest
7 in the LLC so that interest could only be obtained by
8 Gary and Martha; in other words, transferring value
9 from the equity interest to the voting interest which
10 was not supposed to have value.

11 And, finally, that the current
12 management of the LLC was not put in place through
13 legally effective means.

14 Respondent has essentially --

15 THE COURT: All of that leads me to
16 ask what I think is a fairly obvious question. You
17 have described what to me sounds like, in corporate
18 parlance, a 225 action for who should be in charge,
19 and you have described classic breaches of fiduciary
20 duty.

21 If I have a company where there have
22 been breaches of fiduciary duty by the directors, I
23 don't dissolve the company. I fix the board. And
24 that's what I don't understand about this case. It

1 seems to me there are a lot of steps between here and
2 dissolution.

3 MR. JOHNSON: I think that the problem
4 is this split of the voting interest from the economic
5 interest. There isn't really any way to fix the board
6 because the voting interest is purportedly held by
7 someone who is hostile to the trust.

8 THE COURT: But that doesn't mean that
9 Gary Gutchess doesn't have fiduciary duties to the
10 entity, and if he's breaching his fiduciary duties,
11 he's liable at least in the form of damages, isn't he?

12 MR. JOHNSON: I think that he is, but
13 that doesn't solve the equity interest problem because
14 you're going to put someone else in there, and I even
15 think I know who it would be.

16 THE COURT: But doesn't that bring us
17 back to you're probably in the worst venue in the
18 world, because if there's one thing the five of us
19 respect, it's the right of folks to engage in the
20 private ordering of their affairs.

21 And Mr. Gutchess made a decision, and
22 from my perspective it was one that didn't turn out
23 well, but he chose to separate the equity from the
24 voting power, and I recognize this is done frequently

1 for estate planning purposes, but from a corporate
2 governance standpoint, it's somewhat unusual, and when
3 you have unusual events, when you take unusual steps,
4 they tend to yield unforeseen and unusual
5 consequences. That, I would suggest, is where you
6 are.

7 MR. JOHNSON: I think it is, and I
8 think it's very similar to the same sort of unusual
9 and unintended consequences that were present in the
10 Fisk case where they had a 75 percent majority vote
11 that was required, and the majority voters were left
12 in a position where they couldn't get what they wanted
13 done.

14 THE COURT: But the beauty of this is
15 there's no doubt about who's in charge of this train.

16 MR. JOHNSON: But there wasn't any
17 doubt as to who was in charge of that one either. The
18 fellow that had control of over 25 percent of the vote
19 had control.

20 THE COURT: That's right, but here the
21 person who's got the majority of the voting power is
22 able to see that things work out the way she wants to.

23 MR. JOHNSON: That is true, though we
24 do question whether she has that voting power. The

1 problem with that though is that ultimately she may
2 end up with that voting power in that the voting trust
3 will, by its own terms, expire in 2012.

4 So that even if you were to put the
5 control back in the voting trustees, two of whom are
6 dead, by the way, you still really haven't solved that
7 problem, because in two years, it's going to all come
8 up again, and it would probably take two years before
9 that was going to take place.

10 So it is an effective remedy, and
11 that's true of many of the problems that we have here;
12 is that the eggs have been scrambled. They've been
13 badly scrambled, and effective remedy is extremely
14 hard to come up with short of a dissolution. That's
15 really where we come from on it.

16 THE COURT: What your argument is
17 traces back, I think, to the colloquy I had with
18 counsel earlier, which is if you look at the overall
19 purpose, it's been frustrated by the way things have
20 evolved, but I'm not sure I have the right to come
21 down and almost impose my subjective judgment of what
22 might make sense on the parties involved here.

23 And that is ultimately what
24 dissolution of the LLC takes me to, doesn't it?

1 MR. JOHNSON: Well, I don't think so.
2 I think that that has been addressed by other courts.
3 It was an issue in the Fisk case. It was an issue in
4 the Talcott case. It was also an issue in the HCH
5 case. And in those cases, the Court felt that they
6 didn't like the contract, but they weren't going to
7 rewrite the contract because, that, you can't do.

8 The only viable remedy short of
9 rewriting the contract was to dissolve the situation,
10 so to speak, that created the problem. Because you
11 can't continue to live with the problem. You can't
12 have wrongs of the sort that we are experiencing here
13 without an effective remedy.

14 THE COURT: That assumes that damages
15 would not be an effective remedy. Is the problem here
16 really with the LLC, or is it with the trust itself
17 and the way the asset pieces, the bundle of sticks, if
18 you will, was divided up?

19 MR. JOHNSON: The trouble is strictly
20 that there's an LLC, and the problem with the LLC is
21 that it has split the voting interest from the
22 economic interest, and the trustees have no control
23 basically over their investments, and they're
24 fiduciaries, and they have to have control over that.

1 THE COURT: So you're asking me to
2 adopt, as a general principle, that where the voting
3 power and the equity are split, which is something
4 that clearly can be done, that whenever there are
5 irreconcilable differences between those who hold the
6 equity and those who hold the voting power, the LLC is
7 always going to be dissolved?

8 Give me some principle basis so that
9 is not the broad black letter law you're asking me to
10 impose.

11 MR. JOHNSON: No, because I think you
12 have to go one step further. The step further that
13 you have to go is you have to see if there's
14 irreparable harm being done. And I think that that is
15 the case here.

16 If you have a case, for instance --
17 for many years, from 2002 until certainly Homer
18 Gutchess died, there was no problem here that was
19 caused by this because of the people who were running
20 it.

21 Then, when you went beyond that, when
22 you had the voting trustees who were in charge of it,
23 you didn't have a problem. It wasn't until Martha
24 stepped in and Gary stepped in that you had this

1 problem. I think that when you have a problem where
2 people are purposefully acting and have the power
3 under an LLC of this sort, to purposefully deprive the
4 other members of what is rightfully theirs, which is
5 really what's happening here, that at that point, the
6 Court should step in and dissolve the LLC.

7 I don't think that just because they
8 have irreconcilable differences that you have to do
9 that. You have to add in the fact that they are doing
10 harm, which is the case here. If they're just not
11 happy, that's a very different sort of circumstance
12 than what we have here.

13 I think these are very unusual
14 circumstances, and I think that they're the sorts of
15 circumstances that fit the -- there was a case, the
16 associated -- In Re RAO Advisors. Vice Chancellor
17 Strine set out a whole list of things that would be
18 sufficient to dissolve an LLC in the absence of either
19 a limited purpose or a voting deadlock.

20 And I think we have pointed out in our
21 opening brief and showed how the facts of this case
22 fit neatly within those standards that were set out by
23 Vice Chancellor Strine there.

24 I think it's going to be a pretty

1 unusual case that would also fit those -- I don't
2 think it's going to be a run of the mill case that
3 would fit those standards, but I think they are the
4 standards that have been articulated by this, Court
5 and I think it's appropriate to follow them in this
6 case.

7 Could I also address --

8 THE COURT: Absolutely. I don't mean
9 to cut you off.

10 MR. JOHNSON: That's fine. You always
11 want to hear what the Court likes to discuss because
12 that's important.

13 I think it's important I mention all
14 the different things that we say have happened here,
15 and it's interesting that respondents essentially
16 ignored all of them but the last assertion, the one
17 that the current management of the LLC was not put in
18 place through legally effective means.

19 And in an attempt to respond to that
20 allegation, respondent has told us that they have
21 inserted a number of documents into the record which
22 they say that we have incorporated by reference. As a
23 threshold issue, there are two of them that we
24 couldn't possibly have incorporated by reference

1 because, frankly, we've never seen them before.
2 That's Exhibit E and G; Exhibit E being the voting
3 trust certificate and Exhibit G being the voting
4 interest certificate.

5 Not conceding that those are correct,
6 but even if we assume that those documents are correct
7 for purposes of this argument, we think that those
8 documents support our position that the voting
9 interest was not transferred.

10 But even before that, they have
11 asserted that the argument on this point was a
12 hindsight fabrication and is not tendered in good
13 faith because it wasn't included in the petition.
14 There's no basis for that claim.

15 Petitions are carefully written, and
16 petitions should be carefully read. Petitioners
17 carefully allege that Martha was the purported
18 controlling member of the LLC and that Gary was the
19 purported manager right up front in paragraph four.

20 Now, that particular paragraph doesn't
21 explain everything, but it should be a red flag to a
22 lawyer reading the petition that this is an issue
23 that's going to be a real issue in the case. And the
24 use of the word "purported" in the petition indicates

1 that the petitioners do not agree that the status
2 alleged was effectively conferred on the person so
3 described.

4 Later in the petition Gary was
5 described as having effectively, if illegitimately,
6 gained control over the primary sources of revenue for
7 the trust. That certainly indicates that petitioners
8 did not believe that Gary has gained control over the
9 LLC legitimately.

10 In paragraph 37, the petition alleged
11 that Homer purported to transfer the voting rights to
12 Martha, and once again that indicates that the
13 petitioners do not agree that such a transfer was
14 legally effective.

15 And, at the same time, the petition
16 alleges that Homer had already transferred those
17 rights to the voting trust, which, to a reader who is
18 reading carefully, would realize that that's the
19 reason why Homer couldn't then later transfer them
20 again to Martha.

21 In paragraph 49 of the petition, it
22 alleges that Martha purported to terminate the voting
23 trust relying on Homer's purported transfer to her of
24 100 percent of the voting rights in the LLC. That is,

1 of course, because we have already said that Homer
2 didn't have the ability to transfer those rights to
3 her.

4 The petition then goes on to recite
5 all the different actions that Gary did that we've
6 already discussed, and then it says that whether or
7 not Gary has gained control wrongfully, the effect on
8 the trust is the same. And that was to make clear
9 that while petition believes that Gary's control was
10 wrongfully gained, even if it was not, the effect of
11 that control doesn't vary the relief that's requested,
12 and that relief is still necessary.

13 THE COURT: If we were to put those
14 who you would characterize as the good guys back in
15 control because the voting power was improperly
16 transferred to Mrs. Gutchess, wouldn't that alleviate
17 some of the pain and perhaps justify not dissolving
18 the LLC?

19 MR. JOHNSON: I wish I were in a
20 position to label those people as the good guys.
21 There were four of them. Two of them are dead. They
22 were the two closest advisors and confidantes of Homer
23 Gutchess. One of the two is basically on the other
24 side, from what we can see, and this is way outside

1 the petition, Your Honor, and I'm --

2 THE COURT: Better yet, if we don't
3 have enough trustees, some court can always appoint
4 more trustees. But the point is that if the wrong
5 person is exercising authority, isn't the answer to
6 that to get the right people exercising authority and
7 not to dissolve the LLC?

8 MR. JOHNSON: I thought I had already
9 answered that when I pointed out that the voting trust
10 would only run for another two years.

11 THE COURT: I understand that.

12 MR. JOHNSON: Then you're right back
13 out of the frying pan into the fire.

14 THE COURT: So the whole issue of a
15 couple of passing purported references with no
16 accompanying wherever clauses declaring that Gary
17 Gutchess is improperly managing the LLC, the whole
18 question here is almost irrelevant, isn't it, as to
19 who is in charge right now, because the trust is going
20 to expire anyway, which leaves everybody, I think,
21 where they are.

22 MR. JOHNSON: It would in the future.
23 It would merely change the date at which we have this
24 hearing. I think that is correct, Your Honor. That's

1 one of the reasons why.

2 Would you like me to make the
3 documentary argument, because I think their documents
4 are wrong, and I think that their reading of the
5 documents is wrong.

6 THE COURT: I can tell you that I am
7 very reluctant to get into a question of who is
8 properly the manager of a Delaware LLC without the
9 petition specifically seeking that relief and
10 specifically addressing that claim. So I don't think
11 it's all that important.

12 I think that what we are talking about
13 here is I have to take the dispute as it is framed by
14 the petition, and it is whether, on the facts in the
15 petition, dissolution is warranted. And I will tell
16 you that if I were confronted with a real debate
17 about, if the petition had said, A, he's not the
18 proper manager, and B, we ought to dissolve it, I
19 probably would turn to resolving A first, because if
20 putting different management in were a possibility,
21 and as we've talked about, because of temporal
22 constraints, it would be a hollow form of relief no
23 matter what happens, but if it were possible to put in
24 new management, then I think I would be inclined,

1 rather than to engage in the dissolution process, to
2 put in different management and see what happens.

3 MR. JOHNSON: The reason we did not
4 ask for that is the temporal situation is we don't
5 think that that, as a practical matter, would happen
6 before it would be undone essentially, and we'd be
7 back to the same situation.

8 I also -- when going down, one of the
9 things that they have emphasized at length is what I
10 call the deadlock argument. Respondent claims that
11 petitioners have cited no cases that support
12 dissolution under the circumstances of this case
13 because all of the successful cases have involved a
14 voter deadlock.

15 They also say that we have conceded
16 that. And we don't. We have contested whether
17 several of the cases on this issue actually involved a
18 deadlock as that term is understood under Delaware
19 law. The law of deadlock in Delaware developed
20 primarily in the area of closely held corporations
21 which, in many cases, are run by two managers who are
22 also the stockholders. And in such cases, it is not
23 unusual for a real deadlock to occur.

24 A real deadlock, as that term has

1 developed over years of case law, involves the
2 following. The business must be threatened with an
3 irreparable injury. Two, the cause of the malady,
4 which is the irreparable injury, must be a direct
5 result of a division among the directors; and three,
6 the circumstances must be such that the shareholders
7 are unable to vote to terminate this division.

8 The language that I have given you
9 comes from the oft-cited case of Hoban v Dardanella,
10 but similar language also appears in 8 Delaware Code
11 Section 226. This definition is now statutorily
12 mandated in the law of deadlock. Thus, a corporate
13 deadlock, as that term is understood under Delaware
14 law, necessarily involves, at a minimum, at a bare
15 minimum, a need to act, i.e. the presence of some sort
16 of irreparable harm, and that need to act has to have
17 come about as a result of an inability of the company
18 management to agree on a course of action to avoid
19 that irreparable harm.

20 Petitioners took issue with the use of
21 the term "deadlock" in connection with the
22 circumstances of several cases dealing with the
23 dissolution of an LLC under Delaware law because the
24 facts of those cases do not comport with the concept

1 of deadlock under Delaware law.

2 For example, in Haley versus Talcott,
3 the case did not really involve a deadlock because the
4 company was operating profitably. It was paying its
5 bills, and there was no need for the two members to
6 make a decision because there was no irreparable harm
7 alleged. Simply put, the facts of Haley did not
8 constitute a deadlock as that area of the law has
9 evolved in Delaware.

10 Despite that, the Haley court
11 dissolved the LLC, and it did so -- while it talked in
12 terms of deadlock, it did so because the status quo
13 was inequitable, because it exclusively benefited one
14 of the two members of the LLC. Thus, Haley was not
15 decided on deadlock grounds. It was decided on the
16 equities or perhaps the inequities.

17 We also noted Fisk Ventures versus
18 Segal. I think we've already pointed out that that
19 operating agreement required a 75 percent majority
20 vote to do anything. The issue in this case was --
21 the proposal at issue in the Fisk case was a vote to
22 dissolve.

23 Several members wanted to dissolve the
24 company, but the block A member did not want to

1 dissolve. Because he had sufficient voting power to
2 block a 75 percent majority vote, the dissolution was
3 defeated.

4 The petitioner referred to it as
5 length as a deadlock, but it clearly isn't. It was
6 simply a situation in which certain parties who
7 happened to hold a majority of the voting interest did
8 not have sufficient voting power to carry their
9 proposition. But despite that fact, the Fisk court
10 dissolved the company.

11 That's a very similar sort of
12 situation that we have here. It was really based on
13 the unusual voting provisions of the LLC agreement
14 that the Court described as a recipe for disaster.
15 And in a similar manner, in the ECH Management case,
16 the agreement required that to sell the real estate
17 that the company was holding, it required the
18 unanimous vote of the four members.

19 Three of the members wanted to sell
20 the property. The fourth did not. And while the
21 Court described that as a deadlock, it wasn't a
22 deadlock because there was no irreparable harm. There
23 was no need to sell the company. It was just a
24 difference in view, and the three members simply

1 didn't have enough votes to carry their proposal.

2 So there are a number of Delaware
3 dissolution cases that did not involve a deadlock, and
4 we think that the deadlock issue is a non-issue in
5 this case.

6 I think we have gone through the
7 factors that we think are determinative here, and it's
8 our view that if you take those factual circumstances
9 as true, which they have to be in this context, and at
10 this stage of the proceeding, then the factual
11 circumstances alleged are more than sufficient for the
12 Court to order dissolution of the company.

13 THE COURT: Thank you very much.

14 MS. PRASHKER: Your Honor, I think our
15 papers address all of Mr. Johnson's arguments. If the
16 Court has additional questions for me, I would be
17 happy to answer them. Otherwise, I have nothing
18 further.

19 THE COURT: Thank you very much.

20 I don't want to disappoint Mr. Heyman.
21 Let's take a five minute recess. I think I can
22 resolve this from the bench.

23 (The Court recessed from 2:55 p.m.
24 until 3:10 p.m.)

1 THE COURT: In its amended petition,
2 the Homer C. Gutchess 1998 irrevocable trust seeks
3 dissolution under 6 Delaware Code Section 18-802 and
4 Section 18-803 of Gutchess Companies LLC, a Delaware
5 limited liability company. The company has moved to
6 dismiss under Court of Chancery Rule 12(b)(6).

7 The trust owns 98 percent of the
8 company's equity, but at least as reflected in the
9 amended petition, it does not allege that it owns any
10 voting power.

11 Mr. Gutchess initially placed the
12 equity in the trust but held on to the voting power.
13 This was motivated by estate planning considerations.
14 Later, there was concern that retention of voting
15 control would frustrate the estate planning
16 objectives. He then eventually transferred voting
17 control to his wife.

18 As an aside, the trust now suggests in
19 its answering brief, which is where it is first
20 squarely raised, that the transfer of the voting power
21 was not valid or effective as it remains with the
22 trustees of the original voting trust.

23 I don't believe that claim is fairly
24 framed by the amended petition. For example,

1 paragraph 37 refers to the purported transfer of
2 voting rights to the wife, but that is not a fair
3 means of raising an ineffective transfer claim.
4 Obviously, the necessary parties are not present, and
5 that is consistent with the Court's view that this
6 issue simply is not properly before it.

7 The wife eventually appointed
8 Mr. Gutchess's son to manage the company. The trust,
9 or perhaps more accurately the trustees, are not happy
10 with his managerial acts. They have not, however,
11 brought any fiduciary duty claims against him.

12 On this motion to dismiss for failure
13 to state a claim, the Court must accept the trust's
14 well pled allegations of fact and draw all reasonable
15 inferences from them in the trust's favor. If there
16 are sufficient facts alleged to suggest plausibly that
17 the trust would be entitled to the relief which it
18 seeks, the motion to dismiss must be denied.

19 Section 18-802 provides: "On
20 application by or for a member or manager, the Court
21 of Chancery may decree dissolution of a limited
22 liability company whenever it is not reasonably
23 practicable to carry on the business in conformity
24 with a limited liability company agreement."

1 I note that although the petition
2 cites section 18-803, no reference to that section has
3 been made in the trust's answering brief in opposition
4 to the motion to dismiss, and I do not understand the
5 trust to assert that there is some independent basis
6 for dissolution under that section.

7 I also do not join the debate over
8 whether this action should have been brought by the
9 trust or by its trustees.

10 Dissolution of a limited liability
11 company is an extraordinary remedy. There is no
12 deadlock here. All of the voting power is
13 conveniently held by one person. That some who claim
14 an interest in the limited liability company disagree
15 with those in control does not create a deadlock.

16 A deadlock will occur if there is an
17 equal division of power or if some other arrangement
18 such as the requirement of a super majority vote
19 frustrates the members' ability to reach some needed
20 consensus or if one entity, even though a minority
21 holder, is given an equal say in the decisionmaking
22 process.

23 This is a fact-driven analysis, but
24 from the face of the amended petition, there simply is

1 no basis for concluding that there is any deadlock,
2 and frankly, I don't understand the trust to claim
3 that there is deadlock in this sense.

4 The company is not insolvent. Its
5 operations may be relatively passive now. It may not
6 be managed as efficiently as it could be, but there is
7 nothing indicating that the company is in any imminent
8 danger of going under or failing in some other sense
9 of the term.

10 I turn to the company's limited
11 liability agreement to ascertain its purpose. Under
12 "Character of Business" Section 1.4, the "Company is
13 formed for any lawful business purpose or purposes.
14 The initial business purpose of the Company includes,
15 without limitation, holding the stock of Gutchess
16 Lumber Co. Inc. and holding any real and/or personal
17 property. The Company may engage in any activities
18 that are reasonably necessary or appropriate to
19 promote the interests of the Company or enhance the
20 value of its property."

21 This is a general and broad
22 description of the purpose for an entity such as the
23 company. The allegations of the amended petition do
24 not support the inference that the company is unable

1 or likely to be unable to carry on business in a
2 manner consistent with this broad purpose stated in
3 the limited liability company agreement.

4 The trust is not happy with the
5 current arrangement. That is understandable. It
6 holds 98 percent of the equity, but it does not derive
7 the financial benefit from its holdings that it would
8 expect. In short, its expectations have been
9 frustrated.

10 The problem, however, goes back to
11 Mr. Gutches and those who advised him. He separated
12 the equity interest from the voting power, and perhaps
13 that did make estate planning sense. But in the area
14 of corporate governance, it is not uncommon to find,
15 at least as my experience in this job has taught me,
16 that when somewhat unusual actions are taken, those
17 steps tend to breed unusual outcomes. That, frankly,
18 is where we find ourselves.

19 The trust's unhappiness, thus, is the
20 product of two considerations: First, Mr. Gutches'
21 informed and carefully advised decision to split
22 equity and voting, and second, the current manager's
23 conduct.

24 As for Mr. Gutches' decision, the

1 Court must respect the private ordering of affairs.
2 As for the manager, there are no fiduciary duty claims
3 asserted. Simply because things have not worked out
4 as the trust might have liked does not afford the
5 Court a basis for dissolving the limited liability
6 company.

7 The trust cites to Lola Cars, but
8 there, both members had to bring their unique
9 expertise to bear on the common goal of the business.
10 The members otherwise shared equal control and were
11 deadlocked over whether to replace the chief executive
12 upon the 51 percent member's complaints of
13 ineffectiveness and disloyalty.

14 Moreover, both sides in Lola needed to
15 provide funding for the nascent enterprise, and there
16 was a legitimate concern that the business could not
17 carry on without continual and substantial loans and
18 capital contributions from its members.

19 The facts alleged here are materially
20 different from those alleged in Lola Cars. There is
21 no conflict in terms of control here, and the business
22 can lurch forward. In Lola Cars, there was a serious
23 problem with who was running the business, and there
24 was even a bigger problem with whether or not, at

1 least as alleged, the venture could continue.

2 As stated above, the business of Lola,
3 and, for that matter, the business of the entity in
4 Haley, required, by its very nature, the members'
5 mutual cooperation. In other words, Lola was a joint
6 venture between virtually equal business partners,
7 each of which brought special skills to the venture.
8 That clearly is not a factor with regard to the
9 company here.

10 As an aside, I draw my reference to
11 Lola from the motion practice. I have recently tried
12 that, and nothing I say here is to be taken as any
13 kind of product of my experience in trial.

14 Haley is interesting here because, in
15 a sense, there was no abject deadlock in that case,
16 although I think it was inevitable because of the
17 50 percent ownership. But there was no specific
18 dispute that had engendered the deadlock as we
19 normally understand it. Yet dissolution was still
20 granted. Circumstances had changed there which
21 rendered the business structure simply infeasible.

22 Here, the problem arises from the
23 split that Mr. Gutches, on his own, imposed and
24 decided upon. I am simply reluctant to grant the

1 trust relief in these circumstances because I don't
2 know how to draw an effective line for the situation
3 where voting control and the equity are divided, and
4 there is simply no agreement between the two
5 interests.

6 It would seem that there is a risk
7 that there will always be some dispute or substantial
8 risk of some dispute that would trigger a dissolution,
9 and dissolution cannot be that simple a matter to
10 achieve.

11 Perhaps Seneca Investments is the best
12 source of guidance. There the Court first looked to
13 Section 18-802 and whether it was reasonably
14 practicable to carry on the business in conformity
15 with the limited liability agreement. As I have
16 noted, in this instance, the company's limited
17 liability agreement sets forth a broad but general
18 statement of purpose. That has been quoted earlier.

19 I am not able to give some specific
20 limited purpose for the company that the trust might
21 be happy with. As alleged, what the company is doing
22 is not inconsistent with the business purpose set
23 forth in the limited liability company agreement.
24 There is nothing to suggest that this purpose cannot,

1 at least in general terms, be achieved.

2 I have indicated there is no risk of
3 deadlock. I have indicated that the company's
4 management may be passive in a sense. It may not be
5 doing what the trust thinks ought to be done, and it
6 may have made some bad decisions. But that doesn't
7 combine to give me a basis for ordering dissolution.

8 In short, the text of Seneca
9 Investments frames it well. "The role of this Court
10 in ordering dissolution under Section 18-802 is
11 limited, and the Court of Chancery will not attempt to
12 police violations of operating agreements by
13 dissolving LLCs. This court will also not attempt to
14 define some of the business purpose by interpreting
15 provisions of the governing documents other than the
16 purpose clause."

17 I submit, unfortunately, that that is
18 what the trust is now asking the Court to do. In
19 short, I do not find in the allegations of the amended
20 petition, any cognizable basis for dissolution under
21 the controlling provisions of the Limited Liability
22 Company Act.

23 The motion to dismiss will be granted
24 and I will enter an order in due course.

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With that, thank you all very much. I appreciate your coming to Dover.

Recess Court please.

(The Court adjourned at 3:25 p.m.)

CERTIFICATE

I, MAUREEN M. McCAFFERY, Official Court Reporter of the Chancery Court, State of Delaware, do hereby certify that the foregoing pages numbered 3 through 49 contain a true and correct transcription of the proceedings as stenographically reported by me at the hearing in the above cause before the Vice Chancellor of the State of Delaware, on the date therein indicated.

IN WITNESS WHEREOF, I have hereunto set my hand at Dover, this 22nd day of February, 2010.

/s/Maureen M. McCaffery

Maureen M. McCaffery
Official Court Reporter
of the Chancery Court
State of Delaware

Certification Number: 201-RPR
Expiration: 1/31/11