**IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE**

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| JAMES FORSYTHE and ALAN TESCHE, | ) | |
| | ) | |
| Plaintiffs, | ) | |
| | ) | |
| v. | ) | C.A. No. 1091-VCL |
| | ) | |
| ESC FUND MANAGEMENT CO. (U.S.), INC., *et al.*, | ) | |
| | ) | |
| Defendants. | ) | |

# MEMORANDUM OPINION

Date Submitted: June 3, 2010
Date Decided: August 11, 2010

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**LASTER, Vice Chancellor.**

A major bank set up an investment fund for its top employees that would invest side-by-side with the bank. After the fund performed poorly, two investors commenced litigation. The dispute already has generated five written decisions.[1] The defendants now have moved for summary judgment. I previously ruled against their laches argument and declined to reject the plaintiffs' damages theory as a matter of law. This decision addresses the defendants' remaining arguments. I grant the motion as to Trimaran Investments and deny it as to Fund-of-Funds Investments and Merchant Banking Investments. These terms are defined below.

## I. FACTUAL BACKGROUND

The record for this post-close-of-discovery summary judgment motion fills several shelves. I discuss only the principal facts, evaluating the evidence under the familiar Rule 56 standard. The non-movant plaintiffs benefit from any factual disputes and receive all reasonable inferences.

### A. The Co-Invest Fund

In November 1999, defendant Canadian Imperial Bank of Commerce ("CIBC" or the "Bank") formed the CIBC Employee Private Equity Fund (U.S.) I, L.P. (the "Co-

[1] *See Forsythe v. ESC Fund Mgmt. Co. (U.S.)*, 2010 WL 1676442 (Del. Ch. Apr. 21, 2010) (decision on motion to strike expert testimony); *Forsythe v. ESC Fund Mgmt. Co. (U.S.)*, 2007 WL 3262205 (Del. Ch. Oct. 31, 2007) (decision on motion to reargue part of ruling on motion to dismiss); *Forsythe v. ESC Fund Mgmt. Co. (U.S.)*, 2007 WL 2982247 (Del. Ch. Oct. 9, 2007) (decision on motion to dismiss); *Forsythe v. CIBC Employee Private Equity Fund (U.S.) I, L.P.*, 2006 WL 846007 (Del. Ch. Mar. 22, 2006) (decision on redactions following merits ruling in related Section 220 proceeding); *Forsythe v. CIBC Employee Private Equity Fund (U.S.) I, L.P.*, 2005 WL 1653963 (Del. Ch. July 7, 2005) (post-trial decision in related Section 220 proceeding).

Invest Fund" or "Fund"). The internal affairs of the Co-Invest Fund are governed by an Amended and Restated Agreement of Limited Partnership dated March 10, 2000 (the "Partnership Agreement" or "PA").[2]

CIBC created the Co-Invest Fund so that senior CIBC employees could co-invest with CIBC in private equity opportunities. At the time, many of CIBC's competitors had created or were contemplating similar funds.

Units in the Co-Invest Fund were offered for purchase by CIBC employees pursuant to (i) a November 1999 Confidential Private Placement Memorandum (the "PPM") and (ii) a February 2000 Confidential Supplement to the Private Placement Memorandum (the "Supplement" or "Supp.," together with the PPM, the "Offering Documents"). The Fund's initial closing took place on March 10, 2000. The Fund's final closing took place on March 31.

Following its final closing, the Fund commenced operations with about $561 million in commitments from 490 investors. The Fund's investment horizon, *i.e.*, the period during which investments could be made, was six years. The Fund's lifespan was ten years, although the Fund's general partner could extend this term by up to two additional one-year periods to facilitate an orderly liquidation. Between launch and the

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[2] CIBC originally formed the Co-Invest Fund as a limited liability company. CIBC later determined that a limited partnership structure better met its regulatory needs. By March 2000, when the final countdown to the Fund's launch was underway, CIBC had converted the Fund to a limited partnership. The transformation is of only passing historical interest; it explains why some early documents refer to a limited liability company.

end of 2008, the Fund drew down some $508 million, representing approximately 90.5% of its committed capital.

Plaintiffs James Forsythe and Alan Tesche were CIBC employees who purchased limited partner interests in the Co-Invest Fund.

**B. The Co-Invest Fund's Investment Portfolio**

As a co-investment vehicle, the Fund differed from a typical investment fund that can search the financial universe for investment opportunities of its own. The Co-Invest Fund could only invest side-by-side with CIBC in investments selected for CIBC by the CIBC Investment Committee. Moreover, the Fund only could invest in the more limited subset of CIBC investments that also met the Fund's eligibility criteria. The Offering Documents for the Co-Invest Fund explained that its investment portfolio would be divided into three categories: (i) Trimaran Investments, (ii) Fund-of-Funds Investments, and (iii) Merchant Banking Investments.

The different nature of the three investment categories has significant implications for the pending summary judgment motion. The first category – Trimaran Investments – effectively was a pass-through investment in another private equity fund. Once committed to that investment, the Co-Invest Fund had no further discretionary determinations to make. The second and third categories, by contrast, required the Fund to make discretionary decisions about whether to acquire portions of selected existing CIBC investments, whether later to co-invest with CIBC in additional investments, and still later whether to exit from investments.

For the Trimaran Investments, the Co-Invest Fund invested "on a side-by-side basis" with the Trimaran Fund II L.L.C. ("Trimaran"). PPM at P6. Trimaran was a $1 billion private equity fund run by three senior members of CIBC's high-yield investment banking unit. The same team previously managed another CIBC fund – the Argosy Merchant Fund I – that enjoyed considerable success. The PPM explained the Trimaran Investment process as follows: "The Fund generally will invest, on a side-by-side basis, in all investments to be made by the Trimaran Fund *pro rata* . . . . The Fund generally will exit Trimaran Investments at the same price, time, and on a *pro rata* basis with the Trimaran Fund." *Id.* at P12.

For Fund-of-Funds Investments, the Co-Invest Fund would acquire "a diversified portfolio of investments in private equity investment funds . . . sponsored by parties not affiliated with CIBC." *Id.* The PPM explained that "[a] substantial portion of the Fund-of-Funds Investments will consist of [funds] which are part of CIBC's current holdings identified prior to the Closing Date." *Id.* The PPM further explained that the Co-Invest Fund would make future investments "through or *pro rata* with CIBC Oppenheimer Private Equity Partners II, L.P. ('COPEP II'), a new fund-of-funds investment vehicle to be formed by CIBC primarily for third-party investors." *Id.* Elsewhere the PPM stated that the Co-Invest Fund would invest in private equity funds "alongside CIBC" and "on a side-by-side basis with CIBC." PPM at P167-68. For Fund-of-Funds Investments, the Offering Documents did not elaborate on what was meant by "alongside CIBC" or "on a side-by-side basis with CIBC."

The PPM listed thirteen then-current CIBC holdings as possible investments for the Co-Invest Fund. PPM at P168. The Supplement added fifteen more funds to the list and disclosed that CIBC expected to transfer up to 50% of its position in any fund selected for transfer. Supp. at P185, 275. The Supplement also described the pricing mechanism that would be used when transferring eligible Fund-of-Funds Investments.

> With respect to each investment in a private equity fund transferred by CIBC to the Fund, the Fund will pay CIBC an amount equal to CIBC's capital contributions in connection with such investment, plus a funding fee of 7% from the date of the applicable equity contribution by CIBC, less any return of capital received by CIBC in respect of such investment in such private equity fund, to the extent applicable.

*Id.* at P185-86.

Although the Offering Documents listed these investments as possibilities, they warned that no assurances could be made as to which positions would be transferred to the Fund. The PPM also explained that some Fund-of-Funds Investments would *not* be eligible for the Co-Invest Fund.

> No private equity fund investment will be transferred to the Fund where (i) the value of the investment opportunity available to the Fund is less than $2.5 million (*i.e.*, CIBC's total investment is less than $5 million) or (ii) the transfer to the Fund would create a valuation or other issue. With respect to Fund-of-Fund Investments after the Closing Date, neither the Fund nor COPEP II will participate in any private equity investment where the aggregate size of the investment opportunity available to CIBC is less than $7.5 million.

PPM at P168. The Offering Documents did not define what would constitute a "valuation or other issue."

For Merchant Banking Investments, the Co-Invest Fund would acquire a portfolio of direct investments in equity and equity-like securities issued by privately held

companies. PPM at P13. According to the PPM, "Merchant Banking Investments will be made on a side-by-side basis with CIBC in an amount generally equal to 25% of the investment opportunity otherwise available to CIBC. . . ." *Id.* The PPM further stated that "[t]he Fund will generally exit Merchant Banking Investments at the same price, time and on a *pro rata* basis with CIBC." *Id.*

As with Fund-of-Funds Investments, not all CIBC Merchant Banking Investments would be eligible for co-investment. The PPM explained the criteria as follows:

> While the Fund intends generally to invest in all investments made by CIBC . . ., certain investments are not expected to be available to the Fund. These include (i) strategic investments by CIBC, (ii) investments which by their terms do not permit investments other than directly by CIBC, (iii) follow-on investments in existing merchant banking investments, (iv) debt or other investments which are not expected to provide equity-like returns, and (v) investments to be made by any third party fund managed or co-managed by CIBC.

*Id.* The Offering Documents did not define what was meant by a "strategic investment."

The Supplement disclosed that since October 31, 1999, CIBC had made several investments that had been identified preliminarily as being appropriate for the Co-Invest Fund. Supp. at P186. The Supplement stated that "[o]n or shortly after the Closing Date, the Fund expects that CIBC will transfer approximately 25% of its interests in [the identified investments] to the Fund," subject to approval requirements and preconditions to transfer. *Id.* The Supplement stated that no identified investment would be transferred to the Co-Invest Fund "if such transfer would create a valuation or other issue." *Id.* The Offering Documents again did not define what was meant by a "valuation or other issue."

They also did not specify a pricing mechanism for transferred Merchant Banking Investments.

In addition to the specific eligibility criteria and limitations on Fund-of-Funds Investments and Merchant Banking Investments, the Offering Documents outlined additional restrictions on the Fund's ability to engage in related-party transactions with CIBC. *See* PPM at P63 (disclosing limitations on "[t]ransactions between the Fund, CIBC and certain other affiliated persons"). The PPM identified the following limitations:

> One of the limitations on the Fund engaging in transactions with CIBC and its affiliates prohibits the Fund from investing in any investment in which CIBC affiliates own or propose to acquire securities of the same class to be acquired by the Fund unless each such CIBC affiliate, prior to disposing of all or part of its investment, (i) gives the Investment Advisor sufficient (and in any event at least one day's) notice of its intent to dispose of its investments and (ii) refrains from disposing of its investment unless the Fund is given the opportunity to dispose of its investment prior to or concurrently with, and on the same terms as and *pro rata* with, such CIBC affiliated investor.

PPM at P48. The PPM also stated that:

> [T]he Fund may not engage in any transaction with CIBC and its affiliates, unless the Investment Advisor determines that (i) the terms of such transaction, including the consideration to be paid or received, are fair and reasonable to the Members and do not involve overreaching and (ii) the transaction is consistent with the interests of the Members and the terms and reports of the Fund.

*Id.* Section 2.7 of the Partnership Agreement contained contractual provisions implementing these restrictions.

### C. The Co-Invest Fund's Management Structure

The Co-Invest Fund's general partner was defendant ESC Fund Management Co. (U.S.), Inc., a Delaware corporation (the "General Partner" or "ESC"). ESC was 100% owned by defendants Peter H. Sorenson, Dean A. Christiansen, and Vernan L. Outlaw (the "Individual Defendants"). These individuals also comprised ESC's board of directors for the bulk of the time period covered by the litigation. They are referred to consistently in Fund documents as the "Independent Board." Christiansen and Sorenson resigned in April 2005.

The Individual Defendants were identified and recruited by Lord Securities Corporation, an entity independent of CIBC that locates independent directors and provides related services for corporate clients. The Individual Defendants received $15,000 per year for their service as directors, along with expense reimbursement. *See* PA § 4.2(b). This Court previously held that the General Partner was independent of CIBC. *See Forsythe*, 2005 Wl 1653963, at *7.

Under the Partnership Agreement, the General Partner had the "sole right and power" to manage the Co-Invest Fund, but it could and did delegate those duties. PA § 4.1. In fact, the General Partner's delegation of its principal duties appeared in the Partnership Agreement itself. Section 4.1(a)(ii) stated that the General Partner:

> has delegated to the Special Limited Partner the authority to make decisions relating to the selection and disposition of the Fund's Investments (subject

> to Section 4.1(b)(ii),[3] the approval of the CIBC investment committee in the case of Merchant Banking Investments and Fund-of-Funds Investments and the delegation of authority to the Trimaran Advisor and the Trimaran Special Member pursuant to this Agreement and the Parallel Investment Agreement) . . . .

*Id.* § 4.1(a)(ii) (footnote added). Section 4.1(a)(iii) stated that the General Partner "has delegated to the Investment Advisor such of its investment management and other related powers and duties under this Agreement as are provided for herein . . . ." *Id.* § 4.1(a)(iii).

Although the Partnership Agreement expressly contemplated that the General Partner had delegated its duties to these entities, it also provided for the General Partner to retain a non-delegable duty of oversight. Section 4.1 stated that the Investment Advisor and the Special Limited Partner "shall exercise such powers and perform such duties subject to the oversight of the General Partner." *Id.* § 4.1. The PPM represented that oversight by the General Partner "should . . . moderate any direct conflicts of interest between the Fund and CIBC." PPM at P59.

The relative responsibilities of the various management entities also were described in an Investment Advisory Agreement between the Co-Invest Fund and the Investment Advisor. The Investment Advisory Agreement stated that the Investment Advisor would carry out its duties "[s]ubject to the oversight of the General Partner." Investment Advisory Agreement § 2(a). The agreement further provided that "[i]n performing its functions under this Agreement, the Investment Advisor will give

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[3] Section 4.1(b)(ii) caused the authority of the Special Limited Partner to make investment decisions to cease in the event the General Partner removed the Investment Advisor.

appropriate consideration to the provisions of the Private Placement Memorandum of the Fund, including all attachments or appendices thereto (as supplemented or amended from time to time . . .)." *Id.* § 2(a)(ii). The Investment Advisory Agreement specified that responsibility for investment decisions was allocated as follows:

> (i) *Trimaran Investments.* The Investment Advisor shall delegate its investment advisory and management authority with respect to Trimaran Investments to the Trimaran Advisor and the Trimaran Special Member . . . .
>
> (ii) *Fund-of-Fund Investments*. The Investment Advisor shall be responsible for choosing Portfolio Fund and all activities relating to holding such Investments; *provided* that Fund-of-Fund Investments that are made through or along side with COPEP II shall be done on a *pro rata* basis with COPEP II.
>
> (iii) *Merchant Banking Investments.* Merchant Banking Investments and all activities relating to holding such investments shall only be made by the Investment Advisor; *provided* that acquisitions and Dispositions shall require the approval of the CIBC Investment Committee.

*Id.* § 2(c).

In convoluted fashion, the Partnership Agreement and Investment Management Agreement thus established a framework under which the General Partner would oversee the activities of the Investment Advisor and the Special Limited Partner. The Investment Advisor would be responsible for overall management of the Co-Invest Fund's investments. The actual investment decisions for Trimaran Investments would be made by the Trimaran Fund. The actual investment decisions for Fund-of-Funds Investments would be made by the Special Limited Partner but remain "the responsibility of" the Investment Advisor. The actual investment decisions for Merchant Banking Investments could "only be made by the Investment Advisor."

Except for the General Partner, each of these entities was a CIBC affiliate. Trimaran was controlled by three senior members of CIBC's high-yield banking group. The "Special Limited Partner" was defendant CIBC ESC Special Limited Partner, LLC, a Delaware limited liability company and wholly-owned subsidiary of CIBC. The "Investment Advisor" was defendant CIBC ESC Advisors, LLC, also a Delaware limited liability company and wholly-owned subsidiary of CIBC. As discussed in the next section, all of the directors and officers of the Special Limited Partner and the Investment Advisor were CIBC senior executives.

**D. The Co-Invest Fund's Initial Investments**

In late 1999, shortly after CIBC decided to create the Co-Invest Fund, a CIBC team reviewed CIBC's existing Merchant Banking and Fund-of-Funds Investments to determine which were eligible for a co-investment from the Co-Invest Fund. The selection team devised a list of Merchant Banking and Fund-of-Funds Investments for transfer to the Co-Invest Fund. The composition of the selection team and the criteria it used are disputed.

On March 22, 2000, the first meeting of the so-called "Advisory Board" occurred. According to the materials attached to the minutes of the meeting, the Advisory Board consisted of the individuals who were the "officers and directors" of both the Investment Advisor and the Special Limited Partner. CIBC did not distinguish between the two entities or their roles. CIBC did not assign particular individuals to one entity or the other. CIBC did not designate particular decisions or approvals as coming from either entity.

The minutes of the Advisory Board's March 22 meeting are brief and conclusory. They state in their entirety:

> **1. Merchant Banking Investments**
>
> Investments transferred to Merchant Banking category presented for ratification were approved.
>
> **2. Fund of Funds Investments**
>
> Investments transferred to Fund of Funds category presented for ratification were approved.
>
> **3. Transfer Methodology**
>
> Transfer methodology presented for ratification was approved.
>
> **4. Trimaran Investments**
>
> Parallel Investment Agreement with Trimaran presented for ratification was approved.
>
> **5. Other Information**
>
> It was decided that quorum is 3 with majority ruling.
>
> **6. Meeting was adjourned.**

The minutes were created a year later by someone who was not even present at the meeting.

The supporting materials for the potential Fund-of-Funds Investments consisted of three pages. The first was a one-page spreadsheet of 41 fund positions. No valuation information was provided other than CIBC's total commitment, the amount funded to date, and what 25% of each would represent. The dates of the investments ranged from December 16, 1998 until March 1, 2000. A second page identified five Fund-of-Funds Investments "potentially eligible for transfer" that had experienced "valuation events and

are, therefore, no longer eligible for transfer." One fund had "halved in value." Another had a "significant increase in value." A third held an investment that "significantly declined in value." A fourth was "about to or has sold 3 investments at profit." A fifth had been written up in value. The third page consisted of a pared-down version of the initial spreadsheet listing 26 fund positions that were eligible for the Co-Invest Fund.

The materials on the Merchant Banking Investments were similar. The first page listed 34 potential investments. No valuation information was provided other than CIBC's total commitment, the amount funded to date, and what 25% of each would represent. The dates of the investments ranged from November 2, 1999 until March 9, 2000. A second page noted that follow-on investments were considered for the Co-Invest Fund only if larger than CIBC's initial investment. A third page consisted of a pared-down version of the initial spreadsheet that identified 22 eligible Merchant Banking Investments.

The final three pages of the materials explained proposed reductions in the amounts of the investments to be transferred. For Fund-of-Funds Investments, the eligible investments that had larger potential dollar-value commitments were reduced. For Merchant Banking Investments, any proposed transfer of less than $400,000 was excluded.

Nothing in the minutes and supporting materials reflects discussion or evaluation of any particular investment. The supporting materials specifically advised the Advisory Board that "[i]n considering the merits of these investments for the Fund, the Advisor and SLP may take into consideration the approval of the CIBC Investment Committee *but*

*must also consider those matters unique to the Fund, such as the lack of negative tax consequences to participants (i.e. valuation changes) and suitability as per the Fund's stated investment criteria.*" (Emphasis added). The materials also summarized the limitations on eligible investments. For Fund-of-Funds Investments, the materials noted that "[n]o private equity fund investment will be transferred to the Fund where . . . the transfer to the Fund would create a valuation or other issue." The materials did not note the similar restriction on Merchant Banking Investments.

The testimonial record about the Advisory Board's deliberations is sparse. The plaintiffs have cited deposition testimony which, if construed in their favor as the current procedural posture requires, suggests that the Advisory Board neither examined the proposed investments from the perspective of the Co-Invest Fund nor deliberated about the Fund's eligibility requirements. Construed in a pro-plaintiff manner, the testimony suggests that the Advisory Board relied on CIBC's Investment Committee, and if the Investment Committee believed an investment was good for CIBC, the Advisory Board viewed it as good for the Fund. The Advisory Board does not appear to have focused on the Fund's different eligibility requirements or other unique considerations.

Also during the March 2000 meeting, the Advisory Board approved a Parallel Investment Agreement between the Co-Invest Fund and Trimaran. It provided for a $250 million commitment from the Co-Invest Fund. The agreement noted the funds were intended to be "committed for investment on a side-by-side basis." The agreement sought to fulfill this purpose by providing for the Co-Invest Fund to "invest and disinvest in parallel with" Trimaran.

## E. The Co-Invest Fund's October 2000 Investments

The Advisory Board next met to consider investments on October 18, 2000. The minutes again are brief and conclusory. They state in their entirety:

> **1. Merchant Banking Investments**
>
> The follow-on investments presented for ratification were approved.
>
> **2. Fund of Funds Investments**
>
> The private equity fund investments presented for ratification were approved.
>
> It was agreed that the presentation of the various investments being ratified and transferred would be presented in a more streamlined way for the next advisory Board meeting (e.g., appendices).
>
> **3. Trimaran Investments**
>
> No items were presented for ratification.
>
> **4. Transfer of Co-Invest Interests / Valuation Issues**
>
> **[REDACTED]**
>
> **5. Next Capital Call**
>
> **[REDACTED]**
>
> **6. Other Information**
>
> It was communicated that the next Investor Update and Investor Capital statements would be posted on the Website by the end of the month.
>
> **6. Meeting was adjourned (4:00 p.m.).**

These minutes also were drafted the following year by someone not present at the meeting.

The level of detail about investments in the supporting materials is similar to what was provided in March 2000. The only valuation materials consisted of spreadsheets

showing the amount of CIBC's historical investment or commitment. The materials contain one page titled "Investments Eligible for Transfer" which describes cursorily why certain Merchant Banking Investments and Fund-of-Funds Investments were determined to be ineligible. The materials also contained two pages reiterating the investment criteria for the Co-Invest Fund and a third page reminding the Advisory Board of their obligation to evaluate Fund-of-Funds Investments and Merchant Banking Investments from the perspective of the Co-Invest Fund. It stated:

> *Fund-of-Fund investment* [sic] *and CIBC Merchant Banking investments* – all investments are made on a co-investment basis with CIBC; as a result the CIBC Investment Committee has (in the case of the investments considered today) or will have, in the case of future investments, reviewed and passed on the investment merits of these investments for the Fund, **the Advisors and SLP may take into considerations** [sic] **the approval of the CIBC Investment Committee but must also consider those matters unique to the fund, such as the lack of negative tax consequences to participants (i.e. valuation changes) and suitability as per the Fund's stated investment criteria.**

(Emphasis added).

**F. The Fund Performs Disastrously During Its First Two Years.**

During its first two years, the Co-Invest Fund performed disastrously. A schedule of the Fund's investments as of December 31, 2002, shows unrealized losses for the Fund-of-Funds Investments of $18,450,017 and for the Merchant Banking Investments of $30,684,587. Meanwhile, in mid-2001, CIBC asked the three principals of Trimaran to step down as the heads of CIBC's high-yield group. Before this change, every Trimaran Investment had been sourced through CIBC. After the change, Trimaran sourced its investments independently of CIBC. Trimaran also changed its strategy from co-

investing to serving as the principal financier. In September 2002, the Advisory Board discussed reducing the Co-Invest Fund's commitment to Trimaran but later concluded that the Fund would not be able to escape or modify the Parallel Investment Agreement. So badly was the Fund performing that CIBC feared a large number of limited partners would default on the Fund's next capital call.

**G. The Individual Defendants' Lack Of Oversight**

While the Fund was suffering through its first two years, the General Partner was AWOL. The Individual Defendants took action by written consent dated March 29, 2000, to address certain organizational issues. *The Individual Defendants did not meet or take any further action until June 5, 2002.*

Included in the materials supporting the organizational written consent was a memorandum from counsel explaining the Individual Defendants' duties. It stated:

> *Generally*. Similar to the board of directors of any company, the Independent Board has the sole right and power to manage and administer the affairs of the Fund General Partners. The Independent Board has the rights, powers, duties and obligations of a board of directors of a company under the laws of the State of Delaware.

The memorandum explained that while the General Partner had authority to delegate its duties to entities like the Investment Advisor, those entities would exercise power "subject to the oversight of the Independent Board." The materials also included a description of the Co-Invest Fund's investment categories and eligibility criteria.

The March 2000 written consent recited that the Individual Defendants approved the investments selected by the Advisory Board one week earlier. The consent also

recited that the General Partner approved pricing the transfers at cost plus 7%. The materials for the meeting provided an abbreviated explanation for this measure:

> Investments transferred to the Fund by CIBC are transferred at cost plus 7% to compensate CIBC for its cost of carrying these investments. This was specified with respect to the Trimaran and Fund of Fund Investments, but the PPMs were silent with respect to the Merchant Banking Investments. As a result, the CIBC Advisor requests the Board's approval re: same.

The consent also recited that the General Partner approved the Parallel Investment Agreement with Trimaran.

The first actual meeting of the General Partner took place on June 5, 2002, over two years after the Fund launched. After the June 2002 meeting, the General Partner held abbreviated meetings only once per year. Construed in the pro-plaintiff manner required by the current procedural posture, the record suggests barely conscious ratification of whatever CIBC was doing. While legally problematic, the Individual Defendants' somnambulance might have been personally rational. Each served simultaneously as a director of up to 500 other entities. Each was paid only $15,000 for his service to the Co-Invest Fund. CIBC did not really want their meaningful involvement. CIBC's primary business reason for having them around was so it could take the position that it did not control the Fund under applicable banking regulations. It is reasonable to infer for purposes of summary judgment that the Individual Defendants understood they were figureheads and accepted their sinecures.

**H. CIBC Divests Some Of Its Own Positions.**

In 2002, CIBC began selling or writing-down its Merchant Banking assets. In 2003, CIBC pursued sales of its Fund-of-Funds investments as part of a "Private Equity

Portfolio Reduction Plan." After an auction process, CIBC sold major portions of its private equity portfolio. The Co-Invest Fund did not divest its own similar investments side-by-side with CIBC. No one on the Advisory Board raised the idea. When third parties later offered to purchase Fund-of-Funds Investments from the Co-Invest Fund, the Advisory Board rejected the offer.

## I. The Fund Suffers Harm.

The plaintiffs have introduced record evidence and expert testimony indicating that the Fund suffered harm as a result of the investment process followed by the Advisory Board and the lack of oversight by the General Partner. Although the Fund eventually got back into the black after its disastrous initial two years, it posted an annual rate of return of only 2.13% through September 30, 2008. This performance left the Fund approximately $200 million below the returns generated by the lowest quartile of comparable funds.

## II. LEGAL ANALYSIS

Summary judgment is appropriate where the moving party demonstrates that there are no genuine issues of material fact and that the moving party is entitled to judgment as a matter of law. Ct. Ch. R. 56(c). Here, factual disputes preclude summary judgment for most of the alleged wrongs.

### A. The General Analytical Framework And Related Disputes Of Fact

The Partnership Agreement contains an exculpatory provision that limits the liability of the General Partner, Special Limited Partner, and Investment Advisor:

> To the fullest extent permitted by law, none of the Investment Advisor, Special Limited Partner, Independent Board, General Partner, Administrator or their Affiliates and their respective partners, officers, members, shareholders, directors, sub-advisors (including the Trimaran Advisor, the Trimaran Special Member and their respective Affiliates) and employees and the members of the Independent Board (each, an "Indemnified Party"), shall be liable to the Fund or to any Limited Partner for (i) any act or omission taken or suffered by such Indemnified Party in connection with the conduct of the affairs of the Fund or otherwise in connection with this Agreement, the Investment Advisory Agreement or the matters contemplated herein or therein, unless such act or omission resulted from bad faith, willful misconduct, gross negligence or a material breach of this Agreement or the Investment Advisory Agreement or Parallel Investment Agreement by such Indemnified Party . . . .

PA § 12.1. In light of this provision, the plaintiffs only can recover damages if they can establish "bad faith, willful misconduct, gross negligence or a material breach of this Agreement or the Investment Advisory Agreement or Parallel Investment Agreement."

For purposes of summary judgment, I cannot rule out the possibility that the plaintiffs will be able at trial to establish a material breach of the Partnership Agreement. Section 2.7 of the Partnership Agreement contains contractual provisions that restrict the Fund's ability to engage in transactions with CIBC. The Fund was not permitted to engage in such transactions unless:

> the Investment Advisor shall have determined, on behalf of the Fund, that the terms of the transaction, including the consideration to be paid are fair and reasonable to the Limited Partners and do not involve overreaching of the Fund or the Limited Partners on the part of any Person concerned, and that the transaction is consistent with the interests of the Limited Partners, this Agreement, and the Fund's reports to the Limited Partners . . . .

PA § 2.7(i)(A). It is far from clear that the Investment Advisor made these determinations when evaluating investments for transfer to the Fund. Read in a pro-plaintiff manner, the evidence suggests it did not. The determinations are not reflected in

the minutes or suggested by the supporting documents. Witness testimony is far from reassuring.

Section 2.7(i)(B) imposes an additional contractual restriction on CIBC when exiting from a co-investment. It can be read to require "at least one (1) day's notice of [the] intent to dispose of any joint investment with the Fund" and that CIBC "refrain[] from disposing of its joint investment unless the Fund has the opportunity to dispose of its investment prior to or concurrently with, and on the same terms as [CIBC]." PA § 2.7(i)(B). On the current record, CIBC does not appear to have complied with this provision when exiting from Merchant Banking Investments and Fund-of-Funds Investments in which the Fund co-invested.

I likewise cannot rule out the possibility that the plaintiffs will be able at trial to establish a material breach of the Investment Advisory Agreement. Section 2(a)(ii) of that contract provides that "[i]n performing its functions under this Agreement, the Investment Advisor will give appropriate consideration to the provisions of the Private Placement Memorandum of the Fund, including all attachments or appendices thereto (as supplemented or amended from time to time . . .)." The Factual Background, *supra*, describes limitations on Fund investments and eligibility criteria that were set forth in the PPM. There are questions of material fact as to whether the Investment Advisor gave "appropriate consideration" to these provisions. Record evidence suggests that when making its investment determinations for the Fund, the Investment Advisor accepted and relied on the CIBC Investment Committee's prior determination that the investment

benefitted and made sense for CIBC, without considering whether co-investment benefitted or made sense for the Fund.

There are also material questions of fact as to whether the defendants acted in bad faith or with gross negligence. "Bad faith will be found if a 'fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties.'" *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 243 (Del. 2008) (quoting *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 67 (Del. 2006)). Gross negligence encompasses "conduct that constitutes reckless indifference or actions that are without the bounds of reason." *McPadden v. Sidhu*, 964 A.2d 1262, 1274 (Del. Ch. 2008).

The record establishes that the members of the Advisory Board were informed, repeatedly and in writing, about their obligations to make determinations on behalf of the Co-Invest Fund, from the perspective of the Co-Invest Fund and its limited partners, and with respect to the eligibility criteria and other limitations on Fund investments. There are material questions of fact as to whether the Advisory Board carried out its duties or merely accepted prior determinations by the CIBC Investment Committee. Under one interpretation, the Advisory Board did not attempt to carry out its duties at all and knowingly lacked the information it needed to do so. Although the defendants have attempted to defeat these permissible inferences with self-laudatory witness testimony from members of the Advisory Board, the plaintiffs have pointed out conflicts in this testimony. Resolving the conflicting evidence and inferences requires a trial.

The record establishes that the members of the General Partner were informed, in writing, about their duties, including their continuing oversight obligation. It is law of

the case that the Partnership Agreement "impos[ed] on the General Partner an active obligation, at a minimum, to take steps to satisfy itself that the Special Limited Partner and the Investment Advisor actually discharge[d] their delegated duties in compliance with the Partnership Agreement and in a manner loyal to the partnership." *Forsythe*, 2007 WL 2982247, at *7.

> Particularly in light of the general partner's full delegation of its managerial duties to conflicted persons, the residual duty of oversight found in the agreement imposes a duty upon the general partner to take active steps to satisfy itself that the conflicted delegates actually discharge their powers loyally to the fund and in conformity with the partnership agreement.

*Id.* at *1. "The General Partner was required to make at least some effort to oversee the Fund in order to properly discharge its duties." *Id.* at *9.

Despite these obligations, the documentary record suggests that during the first two years of the Fund's operation, while the Fund made the investments that the plaintiffs challenge, the General Partner was nowhere to be found. The Individual Defendants never met. Although they acted once in March 2000 by written consent, they otherwise do not appear to have made an effort to oversee anything, much less taken any active steps. To rebut this powerful documentary inference, the defendants again rely on self-laudatory testimony from their own witnesses suggesting that in fact the Individual Defendants informally checked in from time to time. Perhaps they did, and perhaps they can prove that this was sufficient. But that determination requires a trial.

The foregoing liability standards in turn must be applied in light of the governance structure of the Fund, in which all of the investment decisions and day-to-day management of the Fund was delegated to CIBC affiliates staffed by senior CIBC

executives who received their primary compensation from CIBC. As this Court previously recognized, "the General Partner had no reason to believe that the Special Limited Partner or the Investment Advisor, entities made up of persons whose primary loyalty was and is to CIBC, would likely exercise their delegated duties in a manner that was loyal to the partnership." 2007 WL 2982247, at *7. Ordinarily independent director approval could validate the actions of conflicted day-to-day decision-makers. Taking the pro-plaintiff interpretation of the evidence mandated by Rule 56, the General Partner's disappearance from the scene and its studious impersonation of a rubber stamp eliminate my ability to rely on the Individual Defendants as a cleansing device.

On this record, the defendants are not entitled to summary judgment, except on certain limited issues discussed below. It is entirely possible that the defendants will win at trial, but it is also possible that they will lose. Such is the nature of a case involving disputed issues of fact where the outcome will turn significantly on credibility determinations. If the plaintiffs prevail, then a judgment rescinding the challenged transactions and restoring the Fund's capital plus interest (or awarding rescissory damages if rescission is impractical) would appear well within the range of possible remedies. I now turn to more specific areas of dispute.

**B. Trimaran**

The plaintiffs advance two theories of liability relating to the investments in Trimaran. The first asserts that the Advisory Board caused the Co-Invest Fund to make the investment because "CIBC was being pressured to provide Trimaran with more high-risk seed money than CIBC was willing to risk." Plaintiffs' Answering Brief ("PAB") at

12. There is no evidentiary support for this assertion. The testimony they cite establishes at most that the Trimaran principals wanted to raise a $1 billion fund and that CIBC wanted to commit $250 million. It does not suggest any pressure on CIBC.

Nor have the plaintiffs articulated any theory as to why enabling CIBC employees to invest in Trimaran might constitute a legal wrong. The undisputed facts establish that at the time the Co-Invest Fund was formed, the opportunity to invest in Trimaran was viewed as highly desirable. The Offering Documents and Partnership Agreement made clear that the Co-Invest Fund effectively would hand off to Trimaran. The Offering Documents and Partnership Agreement explained that all investment decisions for Trimaran Investments would be made by the managers of Trimaran. Anyone who opted to invest in the Co-Invest Fund necessarily opted to invest with Trimaran. I grant partial summary judgment to the defendants on claims relating to the Co-Invest Fund's decision to invest in Trimaran.

The plaintiffs' second Trimaran-related theory asserts that: "[T]he Fund's fiduciaries failed to take adequate steps to reduce the Fund's exposure to Trimaran after Trimaran changed its investment strategy. This was due to CIBC's conflicts and self-interest since it was Trimaran's largest limited partner, with a 25% carry (*i.e.*, participation in Trimaran's profits)." PAB at 3. This theory fails to recognize that in 2000, the Co-Invest Fund entered into the Parallel Investing Agreement with Trimaran that contractually bound the Co-Invest Fund to its Trimaran investment.

It is certainly true that in September 2002, the Advisory Board considered whether the Co-Invest Fund could reduce its stake in Trimaran. It is also true that the Advisory

Board recognized the conflicts presented by CIBC's interests in Trimaran, such as CIBC's right to 25% of Trimaran profits, as well as the complications posed by CIBC's relationships with the Trimaran principals. The fact remains that the Co-Invest Fund was contractually bound. The plaintiffs have not suggested how the Co-Invest Fund might have escaped from or modified a binding agreement. I grant partial summary judgment to the defendants on claims relating to the Co-Invest Fund's decision not to reduce its commitment to Trimaran.

Based on these rulings, I do not believe there are any Trimaran-related theories that survive for trial.

**C. Fund-of-Funds Investments**

The plaintiffs advance three theories of liability for the Fund-of-Funds Investments. Disputed issues of material fact preclude summary judgment on two of these theories.

First, the plaintiffs challenge the approval for transfer of Fund-of-Funds Investments by the Advisory Board. They contend that a number of investments presented "valuation or other issues." There was also the requirement that for any transaction between CIBC and the Fund, the Investment Advisor determine that "(i) the terms of such transaction, including the consideration to be paid or received, are fair and reasonable to the Members and do not involve overreaching, and (ii) the transaction is consistent with the interests of the Members and the terms and reports of the Fund." PPM at P48; *see* PA § 2.7. As discussed above, there are material issues of fact as to whether the Advisory Board acted appropriately and made the necessary determinations.

The parties also contest what was meant by the ambiguous concept of "valuation or other issue."

Second, the plaintiffs contend that CIBC sold off many of its Fund-of-Funds Investments without divesting the Co-Invest Fund's positions. The PPM stated that the Co-Invest Fund would invest in private equity funds "alongside CIBC" and "on a side-by-side basis with CIBC." PPM at P167-68. Despite the PPM's disclosures about what side-by-side meant for Trimaran Investments and Merchant Banking Investments, the defendants argue that the concept did not mean a contemporaneous exit for Fund-of-Funds Investments. Resolving the meaning of this ambiguous term requires a trial.

In concluding that a trial is necessary on the disputed Fund-of-Fund Investments, I reject as a matter of law the defendants' advance ratification argument. They point out that many of the Fund-of-Funds Investments were identified in the Offering Documents as potential investments for the Co-Invest Fund. They appear to suggest that they are insulated from liability to the extent those positions were later transferred to the Co-Invest Fund. But the Offering Documents made clear that the enumerated investments were potential investments and would be evaluated for transfer to the Fund in accordance with the Fund's eligibility criteria. The Offering Documents do not exculpate the defendants with respect to their later discretionary decisions about which positions to transfer to the Fund.

Finally, the plaintiffs assert that many Fund-of-Funds Investments were ineligible strategic investments. I cannot accept this claim because "no strategic investments" was an eligibility criterion for Merchant Banking Investments, not Fund-of-Funds

Investments. I therefore grant summary judgment for the defendants on this limited theory of Fund-of-Funds Investment liability.

**D. Merchant Banking Investments**

The plaintiffs discharge a blunderbuss of challenges against the Merchant Banking Investments. Disputed issues of material fact abound, precluding summary judgment except as to one narrow issue.

First, as with the Fund-of-Funds Investments, the plaintiffs challenge the approval for transfer of Merchant Banking Investments by the Advisory Board. To summarize the criteria discussed above, the necessary determinations included (i) whether an investment presented a "valuation or other issues," (ii) whether the investment was a "strategic investment[] by CIBC," (iii) whether the investment was a follow-on investment in an existing CIBC position, (iv) whether "the terms of such transaction, including the consideration to be paid or received, are fair and reasonable to the Members and do not involve overreaching," and (v) whether the "transaction is consistent with the interests of the Members and the terms and reports of the Fund." There are disputed issues of material fact as to whether these determinations were made at all and, if so, made appropriately.

Second, there is a disputed issue of fact as to what was meant by "strategic investments by CIBC." The Offering Documents do not define this ambiguous term, and the parties imbue it with contrasting content.

Third, in addition to questioning the investments that were transferred to the Co-Invest Fund, the plaintiffs also question why other investments were not made available

to the Fund. The March 2000 materials listed Shoppers Drug Mart and Roots Canada Ltd. as eligible investments. The Fund did not co-invest in these deals, which the plaintiffs contend were quite lucrative for CIBC. The defendants have offered explanations for why the deals were omitted, but the plaintiffs have called into question aspects of those explanations. I cannot resolve these disputes at this stage of the case.

Fourth, as with the Fund-of-Funds Investments, the plaintiffs challenge the failure of the Co-Invest Fund to exit its Merchant Banking Investments at the same time as CIBC. The PPM stated that Merchant Banking Investments would be made "on a side-by-side basis with CIBC" and that the "[t]he Fund will generally exit Merchant Banking Investments at the same price, time and on a *pro rata* basis with CIBC." PPM at P13. The plaintiffs have presented evidence indicating that CIBC exited from Merchant Banking Investments while the Fund continued to hold. Fact issues preclude summary judgment on this issue.

Finally, the plaintiffs challenge the pricing for Merchant Banking Investments, which were transferred to the Fund at cost plus a 7% fee. Although this term was disclosed in the PPM for Fund-of-Funds Investments, it was not disclosed for Merchant Banking Investments. The pricing mechanism was ratified by the General Partner at its organizational meeting, but the documentary record suggests at most rote and peremptory approval. Given the record evidence regarding Advisory Board conflicts and General Partner inattention, the defendants will bear the burden at trial of establishing the fairness of this pricing mechanism.

By contrast, to the extent the plaintiffs challenge particular Merchant Banking Investments for not having a sufficient operating history, they cannot prevail. Investing in companies with a significant operating history was a Fund goal, but it was not one of the eligibility criteria for Merchant Banking Investments. I therefore grant summary judgment for the defendants on this narrow theory of Merchant Banking Investment liability.

**E. Aiding and Abetting By CIBC**

The defendants have moved for summary judgment on the plaintiffs' aiding and abetting claim against CIBC. According to the defendants, there is no evidence of "knowing participation" by CIBC in the decisions of the Advisory Board. Here is sufficient evidence: Every member of the Advisory Board that made the investment decisions for the Fund was a CIBC executive. Every individual on whom the Advisory Board claims to have relied was a CIBC executive. CIBC only can act through its employees and agents. Under the factual circumstances presented by this case, the knowledge of these individuals can be attributed to CIBC. *See Forsythe*, 2007 WL 2982247, at *13. The aiding and abetting claim will be tried.

**F. A Handful Of Other Issues**

In addition to the major challenges discussed above, the plaintiffs have raised an assortment of additional challenges. I will make some effort to clear out the underbrush so the parties can focus at trial on the major disputes.

The plaintiffs originally contended that CIBC established the Co-Invest Fund to offload poorly performing investments from CIBC's books. The plaintiffs appear now to

concede that this theory did not pan out in discovery. To the extent they have hedged their bets, I grant partial summary judgment for the defendants on claims relating to CIBC's reasons for forming the Co-Invest Fund. CIBC created the Fund to attract and retain employees. The notion that CIBC established the Fund to harm its employees is not plausible and is unsupported by record evidence.

The plaintiffs next have objected from time to time to the conflating of the Investment Advisor and the Special Limited Partner into the Advisory Board. Given the two entities' overlapping if not duplicative roles and the fact that both were CIBC affiliates, the practical decision to make decisions as a unitary Advisory Board cannot give rise to an independent basis for liability. Put differently, combining the two entities does not constitute a *material* breach of either the Partnership Agreement or the Investment Advisors Agreement. Whether it has regulatory implications for CIBC is something I need not consider. I will evaluate at trial whether the Advisory Board complied with the contractual obligations imposed on both the Investment Advisor and the Special Limited Partner, and I will determine whether the Advisory Board acted in bad faith, engaged in willful misconduct, or was grossly negligent. I grant summary judgment in favor of the defendants to the extent the plaintiffs claim that the conflation of the Investment Advisor and the Special Limited Partner was a separate legal wrong.

The plaintiffs also advance various arguments based on the leveraged nature of many limited partners' investment in the Co-Invest Fund. The Offering Documents explained that CIBC employees could opt to take an interest-bearing loan from CIBC that would be used to multiply their capital investment in the Fund by up to three times.

Many limited partners leveraged their investments in this fashion. In what seems to be an economic coercion argument, the plaintiffs contend that "investors felt they were pressured to leverage their investment." PAB at 15. The plaintiffs also seem to contend that CIBC somehow acted wrongfully in structuring the loans as 50% recourse and 50% non-recourse. *Id.*

I grant summary judgment in favor of the defendants on the leverage issues. The nature of the opportunity was fully disclosed, and the plaintiffs never argued otherwise. All of the limited partners were sophisticated investors with the ability to decide for themselves whether to use debt in an effort to magnify their returns. All were high-level CIBC employees who agreed contractually that they were sufficiently qualified to invest in a private investment company. PA § 14.12(c)(ix). As this Court previously held, "the decision to take out loans, like the decision to invest in the Fund, was completely voluntary." *Forsythe*, 2005 WL 1653963, at *1. The return-enhancing attributes of leverage work reciprocally on the downside. Limited partners who took on that risk cannot now shift the consequences of their decision to CIBC, any more than CIBC could demand a portion of their returns had their bet turned out well.

There is the minor matter of Count III of the plaintiffs' complaint, which seeks judicial dissolution of the Co-Invest Fund. The plaintiffs have failed to pursue this claim, and I grant summary judgment against the plaintiffs on this count.

Finally, in light of the above rulings, I do not reach the plaintiffs' pending motion to strike and exclude various items of evidence. I will consider these evidentiary issues, if necessary, at the pre-trial conference or during the course of trial.

## III. CONCLUSION

The defendants' motions for summary judgment are granted in part and denied in part. The plaintiffs' motion to strike and exclude evidence is denied without prejudice. IT IS SO ORDERED.