IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

GLENN B. SHOWELL, Plaintiff, v. WILLIAM H. PUSEY, RICHARD H. HATTER and ROBERT M. HOYT & COMPANY, L.L.C., a limited liability Company of the State of Delaware, Defendants.	)	C.A. No. 3970-VCG

MEMORANDUM OPINION

Submitted: August 1, 2011
Decided: September 1, 2011

Mary R. Schrider-Fox, Esquire, of STEEN, WAEHLER & SHRIDER-FOX, LLC, Ocean View, Delaware, Attorney for Plaintiff.

Stephen P. Ellis, Esquire, of ELLIS & SZABO, LLP, Georgetown, Delaware, Attorney for Defendants.

GLASSCOCK, Vice Chancellor.

This matter involves the interpretation of a limited liability company operating agreement.[1] The Petitioner, Glenn B. Showell ("Showell"), was a member of Robert M. Hoyt & Company, L.L.C. ("Hoyt"), an accounting firm. Before February 2007, Showell held a 29% interest in Hoyt. The Respondents, William H. Pusey ("Pusey") and Richard H. Hatter ("Hatter") were the remaining members of the LLC at that time. In early 2007, Showell "retired" from Hoyt. The Petition asks that this Court construe the provisions of the Hoyt Operating Agreement ("Operating Agreement") to determine what value, if any, Showell is due for his interest in Hoyt as a consequence of his departure from the company. For the reasons that follow, I conclude that Showell is entitled to receive his share (29%) of the liquidation value of Hoyt as of the date of his "retirement" from the Company.

I. FACTUAL BACKGROUND

Prior to October 2000, Pusey and Showell were partners in a Sussex County accounting firm ("old Hoyt"). Old Hoyt had offices in Rehoboth and Millsboro. Showell and Pusey worked in the Millsboro office. Around that time, the old Hoyt partnership dissolved, and Pusey and Showell formed the LLC at issue here, Hoyt. While its Operating Agreement states that Hoyt was founded to pursue any lawful

[1] Initially, the Petition also sought a partition of real property, but that part of the action has settled.

business, in fact Hoyt is an accounting firm operating in Millsboro. As initially formed, Hoyt had two members, Pusey, who held a 68% interest in Hoyt, and Showell who had a 32% interest in Hoyt.[2] In January 2003, Hatter became a member of the firm, leaving the membership interests at: Pusey 61%, Showell 29%, and Hatter 10%.

Since the l7th century, Showell's family has owned a waterfront farm on Long Neck.[3] For many decades, the Showell family has operated a trailer park on this property. In 2004, Showell's father approached him and asked him to return to the family business, which needed his assistance. Showell agreed, and approached Pusey, offering to retire from Hoyt. Pusey convinced Showell to stay on as a member of Hoyt. Showell then offered to work part-time, and to forego his draws as a member, instead receiving an hourly amount for time actually worked at Hoyt. Pusey agreed to this.[4] The parties disagree as to how much time Showell was expected to devote to Hoyt during the very busy "tax season." According to Pusey, he asked Showell to work full-time during tax season; Showell does not recall agreeing to this.[5] At any rate, Showell's time devoted to Hoyt grew less as time went on; by the 2006 tax season (during which time Hoyt accountants

[2] Operating Agreement at Schedule A.
[3] Trial Tr. 30 (Showell).
[4] Trial Tr. 36 (Showell); Trial Tr. 113-15, 129 (Pusey).
[5] Trial Tr. 114-15 (Pusey); Trial Tr. 47, 63-64 (Showell).

generally work 60 to 70 hour weeks), Showell's sparse appearances at the firm caused complaints from clients and grumbling among employees. Pusey began reassigning clients from Showell to Hatter and other accountants, which angered Showell. By the beginning of 2007, the parties agreed that Showell should retire from Hoyt.[6] Showell's last day at work was February 14, 2007.[7] The parties are in agreement that Showell is no longer an active member of Hoyt.

Because the parties could not agree on the amount to which Showell was entitled upon his "retirement" from Hoyt, Showell filed this Petition on August 15, 2008. The litigation moved slowly: the parties had encountered "various difficulties" during discovery and had engaged in a voluntary (unsuccessful) mediation sometime in 2009. Eventually, the parties requested a trial date in 2011. A hearing was held on June 9, 2011, and the parties have submitted cross-memoranda of law. This is my decision on the issues raised at that hearing.

II. THE OPERATING AGREEMENT AND STATUTORY LAW

Limited liability companies exist pursuant to the Delaware Limited Liability Company Act, 6 *Del. C.* §18-101, *et seq.* The relationship between members of the LLC, and their rights and duties, are as set forth in the Limited Liability Company

[6] *See, e.g.*, Trial Tr. 141 (Pusey).
[7] Trial Tr. 66 (Showell).

Agreement (here, the "Operating Agreement").[8] Therefore, it is first to the language of the Operating Agreement itself that I must look in order to determine Showell's rights in this situation.

Hoyt's Operating Agreement does not allow for the withdrawal or resignation of its members.[9] The Operating Agreement provides for the transfer of membership interests[10] as well as for the dissociation of a member in certain situations,[11] but specifically provides that (absent the transfer of the member's interest to another) "no Member shall be entitled to withdraw or resign from the Company."[12] Should a member become incapable of carrying on as a member, due to, for example, disability or bankruptcy, the member shall be deemed an Economic Interest Owner, entitled to disbursements from the LLC, but not to participate in its operation.[13]

The Operating Agreement also provides that issues regarding transfer or repurchase among the members may be addressed by supplemental agreement.[14]

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[8] 6 *Del. C.* §1101(b) provides that "it is the policy of this Chapter to give the maximum effect to the principal of freedom of contract and to the enforceability of limited liability company agreements."
[9] Operating Agreement, Article 7.3.
[10] Operating Agreement, Article 6.
[11] Operating Agreement, Article 7.
[12] Operating Agreement, Article 7.3. This is consistent with the default provisions of the LLC Act, according to which, when an LLC agreement is silent as to withdrawal, it is construed as prohibiting withdrawal. *See* 6 *Del. C.* § 18-603.
[13] Operating Agreement, Articles 7.1, 7.2.
[14] Operating Agreement, Article 6.8.

Hoyt's original members, Pusey and Showell, did agree to such a supplemental agreement, which is attached to the Operating Agreement as Supplemental Exhibit 1. That agreement specifically addresses repurchase of a member's interest in Hoyt upon a "Retiring Event."[15] Under the applicable section, Article 1.1, of Supplemental Exhibit 1 to the Operating Agreement (the "Supplemental Agreement"), Retiring Events are defined as "the first to occur of (i) the death of such Member, (ii) the bankruptcy of such Member, or (iii) the [d]isability . . . of such Member."[16] The voluntary "retirement" of Showell agreed to by Showell and Pusey (and acquiesced in by Hatter) is not a Retiring Event as defined under the agreement, and the parties agree that nothing in the Operating Agreement or Supplemental Agreement allows for, nor sets forth Hoyt's obligation to a member upon, a voluntary retirement.

Finally, the Operating Agreement provides for its own amendment "with the consent of the Members holding at least 75% of the Membership Interests."[17] An amendment regarding "the compensation, distributions, or rights of reimbursement to which . . . Member(s) are entitled" requires the consent of the member affected by the amendment.[18]

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[15] Supplemental Exhibit 1 to Operating Agreement, at Article 1.1.
[16] *Id.*
[17] Operating Agreement, Article 10.1.
[18] *Id.*

III. DISCUSSION

By the beginning of 2007, Showell and Pusey, representing 90% of the ownership of Hoyt, had reached an agreement allowing Showell to retire (in the ordinary sense of the word).[19] The parties agree that Showell has not been a member of Hoyt since that time, and Showell does not seek the distribution of revenue to which a member would be entitled after the beginning of 2007. I also find, based on the trial testimony as well as the actions of the parties, that the parties agreed that Hoyt would pay Showell for his interest in Hoyt.[20] The parties did not reach an agreement, however, on what amount Showell should receive from Hoyt for surrendering his membership. Showell argues that his "retirement" entitles him to 29% of the value of Hoyt as a going concern. He bases his understanding on 6 *Del. C.* § 18-604, which provides that, if an LLC agreement allows resignation of a member without specifying the member's right to reimbursement upon such resignation, the member is entitled to his proportionate share of the "fair value" of the LLC.[21] The Respondents point to the fact that,

[19] In December 2006, Pusey wrote a letter to customers explaining that Showell had retired from Hoyt: "As of December 31st, 2006, Mr. Showell will be retiring from the firm. This decision was made after considerable thought by the company and Mr. Showell personally. At this time, it appears that Mr. Showell will not be practicing accounting in the public sector." Trial Ex. 2; Trial Tr. 140-41 (Pusey).

[20] Showell testified that Pusey told him that he should determine the amount to which he was entitled upon retirement, but admonished him not to be "greedy." Trial Tr. 39-40 (Showell).

[21] The statute provides, "[U]pon resignation any resigning member is entitled to receive any distribution to which such member is entitled under a limited liability company agreement and, if

while the Operating Agreement explicitly disallows withdrawal, it does provide for retirement under certain circumstances, and the parties specifically provided for the right of the LLC to purchase a Retiring Member's interest for an amount representing the member's proportionate share of the liquidation value, not the going concern value, of Hoyt.[22] The Respondents argue that, since the Operating Agreement does not permit Showell to retire, he is entitled to no compensation, or, in the alternative, they argue that Showell should receive his share of the liquidated value of Hoyt.[23]

It is true that the Operating Agreement and Supplemental Agreement do not specify the distribution to which Showell is entitled upon his voluntary retirement. The Agreements also do not *allow* for his retirement in the first place. Thus, 6 *Del. C.* § 18-604 does not necessarily apply here, as Petitioner argues.[24] Because greater than 75% of the membership interests in Hoyt agreed to modify the agreement to allow Showell's "retirement," because Showell has in fact "retired,"

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not otherwise provided in a limited liability company agreement, such member is entitled to receive, within a reasonable time after resignation, the fair value of such member's limited liability company interest as of the date of resignation based upon such member's right to share in distributions from the limited liability company."

[22] Supplemental Agreement, Article 1.1.

[23] The primary thrust of their argument is that Showell should only be entitled to the liquidation value, not the going concern value, of the Company.

[24] *See, e.g.*, ROBERT L. SYMONDS, JR. & MATTHEW J. O'TOOLE, SYMONDS & O'TOOLE ON DELAWARE LIMITED LIABILITY COMPANIES § 1.03[A][3] at 1-16 (2007) ("The statute's default rules are designed to bridge gaps created by omissions in the limited liability company agreement; they are not intended to substitute for the agreement itself.").

and because the parties manifestly neglected to reach an agreement on Showell's and Hoyt's rights and responsibilities upon Showell's "retirement," I must now interpret the Agreements as a whole in light of the parties' agreement allowing Showell to retire. I do so regarding the Operating Agreement and Supplemental Agreement in their entirety, in an attempt to harmonize Showell's "retirement" with the intent of the parties as expressed in their agreement.[25]

The Supplemental Agreement provides in great detail what happens when a member Retires (in the defined sense). In that case "[t]he company shall have the option to purchase the entire Membership Interest held by such Retiring Member (or such Member's successor in interest) on the date of the Retiring Event."[26] The Agreement supplies the purchase price: "The price to be paid by the Company for a Retiring Member's Membership Interest shall be an amount equal to the '*Net Equity*' [as defined later in the Supplemental Agreement] of the Retiring Member's Interest. . . ."[27] Article 1.6 defines net equity: "The "'*Net Equity*' of a Member's

[25] LLC agreements are contracts whose provisions are interpreted using the basic rules of contract law. The "Court's role is to 'effectuate the parties' intent'" and, to do so, "[t]he Court 'must construe the agreement as a whole, giving effect to all the provisions therein.'" *Bank of New York Mellon v. Commerzbank Capital Funding Trust II*, 2011 WL 3360024, at *7 (Del. Ch. Aug. 4, 2011) (quoting *Lorillard Tobacco Co. v. Am. Legacy Found.*, 903 A.2d 728, 739 (Del. 2006); *E.I. du Pont de Nemours & Co. v. Shell Oil Co.*, 498 A.2d 1108, 1113 (Del. 1985)); *see also In re Cencom Cable Income Partners, L.P. Litig.*, 2000 WL 640676, at *5 (Del. Ch. May 5, 2000) ("In order to discern the intent of the parties, the contract should be read in its entirety and interpreted to reconcile all of the provisions of the agreement.").

[26] Supplemental Agreement, Article 1.1(a).

[27] Supplemental Agreement, Article 1.1(b).

Interest, as of any day, shall be the amount that would be distributed to such Member in liquidation of the Company. . . ."[28] Once the member's share of the liquidation value has been determined pursuant to Article 1.6, and once the Company elects to purchase the membership interest, the Supplemental Agreement provides for the schedule of payments of the amount due the Retiring Member:

> The redemption price for the Retiring Members Interest shall be paid in installments as follows: ten percent (10%) shall be paid on the closing date, together with interest from the date of the Retiring Event through the closing date at the Applicable Federal Rate in effect on the date of the Retiring Event for obligations of similar duration. The remainder of the redemption price shall be paid in equal annual installments on the next five (5) consecutive

[28] Article 1.6 provides in full that:

> The '*Net Equity*' of a Member's Interest, as of any day, shall be the amount that would be distributed to such a Member in liquidation of the Company pursuant to Section 8.3(d) of the Operating Agreement if (1) the Gross Asset Values of the Company assets were adjusted as set forth in Section 8.4 of the Operating Agreement, (2) all of the Company's assets were sold for their Gross Asset Values, as so adjusted, (3) the Company paid its accrued, but unpaid, liabilities and established reserves pursuant to Section 8.3(b) of the Operating Agreement for the payment of reasonably anticipated contingent or unknown liabilities, and (4) the Company distributed the remaining proceeds to the Members in liquidation, all as of such day; provided that in determining such Net Equity, no reserve for contingent or unknown liabilities shall be taken into account if such Member (or such Member's successor in interest) agrees to indemnify the Company and all other Members for that portion of any reserve as would be treated as having been withheld pursuant to Section 8.3(b) of the Operating Agreement from the distribution such Member would have received pursuant to Section 8.3(d) of the Operating Agreement if no such reserve were established. The Net Equity of a Member's Interest shall be determined, without audit or certification, from the books and records of the Company by the accounting firm regularly employed by the Company, and the amount of such Net Equity shall be disclosed to the Company and each of the Members by written notice. The Net Equity determination of such accountants shall be final and binding in the absence of a showing of gross negligence of willful misconduct.

> anniversaries of the closing date. The unpaid portion of the redemption price shall bear interest, compounded monthly from the closing of the date at the same Applicable Federal Rate, and all such interest accrued through the date each installment of the redemption price is due shall be paid simultaneously with each such installment.[29]

Read together, the provisions of the Operating and Supplemental Agreements become clear. First, a Member has no right to voluntarily withdraw or retire from Hoyt. If, however, one of the enumerated Retiring Events occurs, including death, bankruptcy or disability, the person (or his successor) ceases to become a Member and becomes a "Retiring Member."[30] If such a Retiring Event occurs, Hoyt may exercise its option to purchase the Retiring Member's entire membership interest, or may treat the Member as an "Economic Interest Owner," in which case the Retiring Member is "entitled to receive distributions to which the Member would otherwise have been entitled had the Member remained a Member."[31] If the Company exercises its option to purchase the Member's interest, the purchase price is based on the Retiring Member's proportionate share of the liquidation value of the Company, to be paid over the course of five consecutive years.[32]

The provisions of the Supplemental Agreement allowing the LLC to

[29] Supplemental Agreement, Article 1.1(d).
[30] Operating Agreement, Article 7.1; Supplemental Agreement, Article 1.1(a).
[31] Operating Agreement, Article 7.2.
[32] Supplemental Agreement, Article 1.1

purchase a Retiring Member's interest at liquidation value and over a period of years are obviously meant to protect the ongoing existence of Hoyt (by limiting Hoyt's obligation to the Retiring Member, and spreading that obligation out over five years) and also to protect it from an obligation to make ongoing distributions to former members who are no longer contributing to the firm's profitability. Although the reason for Showell's retirement (to assist in the operation of a troubled family business) is not a "Retiring Event" under the terms of the Supplemental Agreement, Showell and Pusey, representing 90% of the interests of Hoyt, agreed that Showell *could* retire and that his interest would be purchased by Hoyt. Because the Agreements read as a whole evidenced careful planning for the obligations of Hoyt upon a member's retirement, I reject Showell's argument that the "default" provision of 6 *Del. C.* § 18-604 should apply. The members (including Showell), in creating the Operating Agreement and Supplemental Agreement, did contemplate the effects of a retirement and provided specifically for the obligations of Hoyt upon such an event happening. The statute itself provides that "fair value" is the measure of the LLC's obligation to a withdrawing member *only* if the Agreement fails to provide otherwise. Because Hoyt permitted Showell to retire despite the fact that his reason for retiring did not constitute a "Retiring Event," and because I find that an agreement existed to purchase his

interest, the measure of Hoyt's obligation is as set out in the Supplemental Agreement, Article 1.1 as though a Retiring Event had occurred. That obligation is based on the liquidation value of the Company as set out in the Supplemental Agreement at Article 1.6, and payment is due on the schedule provided and at the interest rates provided in the Supplemental Agreement, Article 1.1(d).[33]

The parties presented experts at trial. While their experts disagreed in matters of fair value, they were in general agreement as to the liquidation value of Hoyt.[34] The parties should agree on the obligations of Hoyt under Articles 1.1 and 1.6 of the Supplemental Agreement, using the agreed upon liquidation value, and a

[33] According to Showell's expert, Jennings P. Hastings, the "fair value" which Showell seeks would include a component for good will, including the value of Hoyt's client list. Trial Tr. 84 (Hastings). Even if fair value were the measure of compensation due Showell here, which it is not, I was persuaded by Hoyt's expert, Clyde G. Hartman, that the client list would be of minimal value because the Operating Agreement lacks a provision prohibiting a Retiring Member from competing with Hoyt. Indeed, the Operating Agreement provides that members *may* compete with Hoyt—even *while they are still members*. *See* Operating Agreement, Article 1.6 ("Any Member may engage in or possess an interest in other business ventures of any nature, whether or not similar to or competitive with the activities of the Company."). Therefore, even if "fair value," rather than liquidation value, were to be used to calculate the amount to which Showell is entitled here, the net difference would be minimal.

[34] Hartman, Hoyt's expert, testified that the liquidation value for Showell's 29% interest is in the neighborhood of $65,000. Trial Tr. 188 (Hartman). Hastings, Showell's expert, testified that he believed Showell was due approximately $281,500—which he calculated as 29% of the going concern value of Hoyt. Trial Tr. 87-88 (explaining that his valuation "mirrors the valuation done by Robert M. Hoyt & Company with the exception that there is a good will value of the client list adding $665,180 and Pusey receivables [excess draws, as discussed in Section IV] of $80,779. Comes down to showing equity of $970,316 [which,] using Glenn Showell's ownership percentage come[s] up to $281,392 value. And I rounded that to $281,500."). According to Hartman, the only significant difference between the two experts' valuation opinions was the inclusion of those two items—the excess draws and the "value" of the customer list. Trial Tr. 190 (Hartman). Excluding those two items, the experts appear to be in agreement on the liquidation value.

"Retiring Event" date of February 14, 2007, and submit a form of order consistent with this Opinion.

IV. OFFSETS AND ADJUSTMENTS

Showell argues that Pusey took draws from the LLC to which he was not entitled. Showell argues that these excess draws represent an asset of Hoyt and must be reflected in its valuation for purposes of compensating him for his Membership Interest. Showell produced a summary which he testified represented his interpretation upon examining Hoyt's books, showing thousands of dollars of excess draws to Pusey dating back to 2001. No documentary evidence was submitted supporting Showell's claims, however. Pusey has denied excess draws, and has pointed out that Showell had access to the books of Hoyt and never made an objection to the supposed excess draws. I found Showell's testimony concerning the excess draws to be unpersuasive. Similarly, witnesses for the Respondents testified that Showell, in drastically cutting back his hours during tax season, caused Hoyt to lose clients and significant revenue. This testimony was likewise unpersuasive and the damage to Hoyt, if any, not quantifiable. Accordingly, I find no offsets or adjustments, in either direction, necessary. That is, Showell is not entitled to include the value of Pusey's alleged excess draws in the valuation calculation, and Hoyt is not entitled to offset the alleged loss of

clients and revenue caused by Showell against its payment for Showell's interest in Hoyt.

V. CONCLUSION

The members of Hoyt agreed that, the Operating Agreement notwithstanding, Showell was allowed to "retire" from Hoyt and be compensated for his interest. Showell was therefore entitled to be compensated as though a Retiring Event had occurred on February 14, 2007, the date on which he states that he withdrew from the Company.[35] Hoyt is obligated to compensate Showell for his interest pursuant to the terms of Section 1.1 of the Supplemental Agreement. The parties shall inform me whether issues remain in computing the amount due Showell under that Article; otherwise, the parties shall submit a form of order conforming to this Opinion within 30 days.

IT IS SO ORDERED.

[35] Trial Tr. 66 (Showell).