EFiled: Jan 13 2009 3:45PM
Transaction ID 23289342
Case No. 3017-CC

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

FISK VENTURES, LLC, Petitioner, v. ANDREW SEGAL, Respondent, and GENITRIX, LLC, Nominal Respondent.	)))))))))))))))	Civil Action No. 3017-CC

MEMORANDUM OPINION

Date Submitted: October 24, 2008
Date Decided: January 13, 2009

Jon E. Abramczyk and John P. DiTomo, of MORRIS, NICHOLS, ARSHT & TUNNELL LLP, Wilmington, Delaware; OF COUNSEL: Steven C. Seeger, of KIRKLAND & ELLIS LLP, Chicago, Illinois, Attorneys for Petitioner.

Vernon R. Proctor and Jill K. Agro, of PROCTOR HEYMAN LLP, Wilmington, Delaware; OF COUNSEL: Kevin J. O'Connor, of WOLFBLOCK LLP, Boston, Massachusetts, Attorneys for Respondent Andrew Segal.

CHANDLER, Chancellor

This case presents the narrow question of whether it is "reasonably practicable," under 6 *Del. C.* § 18-802, for a Delaware limited liability company to continue to operate. When such a company has no office, no employees, no operating revenue, no prospects of equity or debt infusion, and when the company's Board has a long history of deadlock as a result of its governance structure, more than ample reason and sufficient evidence exists to order dissolution. Accordingly, I will grant petitioner's motion for judgment on the pleadings and order that dissolution of the limited liability company occur as contemplated in the company's charter.

I. BACKGROUND

Genitrix, LLC ("Genitrix" or the "Company"), originally a Maryland limited liability company, was formed by Dr. Andrew Segal in 1996 to commercialize his biotechnology concepts of directing the human immune system to attack cancer and infectious diseases.[1] Although initially promising, the Company's financial condition has deteriorated to the point where currently Genitrix is in critical financial straits.

The LLC Agreement provides that Genitrix's business purpose is:

> (a) to engage in research and development, and /or generate through the manufacture and sale and licensing of biomedical technology, including

[1] Given the procedural posture of this case and consistent with the standard of viewing the facts in the light most favorable to the nonmoving party, I take the facts in this opinion from the complaint and respondent's answer to the complaint.

> that related to the use of opsonin molecules, in combination with other organic molecules, to produce immunizing and therapeutic drugs for human and animal diseases, and (b) to engage in all action necessary, convenient or incidental to the foregoing. Without the express approval of the Board, the Company shall not engage in any other business activity.

As this Court stated in a previous opinion, "[t]he Company has no office, no capital funds, no grant funds, and generates no revenue."[2] Genitrix, as it currently stands, is unable to operate in furtherance of its business purposes.

In forming Genitrix, Segal obtained a patent rights license from the Whitehead Institute of Biomedical Research ("Whitehead") concerning the Company's core technology. In 1997, Genitrix entered into a Patent License Agreement (the "Whitehead Agreement") with Whitehead and Massachusetts Institute of Technology.

The Whitehead Agreement was entered into among Genitrix, Whitehead, and M.I.T. It provides for the exclusive license to Genitrix of certain patent rights, owned by Whitehead. Genitrix paid for the prosecution and issuance of the patents owned by Whitehead. As set forth in Article 2 of the Whitehead Agreement, the license gives Genitrix the worldwide right to develop, sell and commercialize Licensed Products and Licensed Services derived from the patent rights. Article 11 of the Whitehead Agreement provides that the license is not assignable, except

[2] *Fisk Ventures v. Segal*, C.A. No. 3017-CC, 2008 WL 1961156, at *6 (Del. Ch. July 3, 2008).

in limited circumstances including "in connection with the sale or transfer of all or substantially all of Genitrix's equity and assets."[3]

In September 1997, H. Fisk Johnson, head of Fisk Ventures, LLC, became an investor in Genitrix. As a condition to Johnson's investment, Genitrix was redomiciled in Delaware. In the initial investment round, Johnson contributed $842,000 in cash in exchange for Class B interests in Genitrix. Investments by other Class C investors brought the total cash investment in Genitrix to $1.1 million. Segal received a $500,000 Class A investment credit in exchange for his contribution of patent rights that he obtained from Whitehead. To continue operating, Genitrix has relied on equity and debt investments and grants from institutions to provide capital. In recent years, both Segal and Fisk Ventures have paid for certain Company expenses.

As a Class B member of Genitrix, Fisk Ventures negotiated a "Put Right" with respect to the Class B membership interests, found in § 11.5 of the LLC Agreement. Section 11.5(a) allows "the holders of the Class B Interests . . . to sell any or all of such Member's Class B Interests to the Company on such terms as are set forth herein," at any time after "the fourth anniversary of the date of this Agreement." After exercising the Put Right, the LLC Agreement requires an adjustment of the book value of all Company assets based upon an independent

[3] Whitehead Agreement, Art. 11, Segal Aff., Ex. A.

valuation of Genitrix conducted by "a nationally recognized, reputable investment banker."[4]

Under § 11.5(c), the put price for the Class B interests is deemed to "equal the amount of such Class B Interest holder's Capital Account balance after such balance has been adjusted as required by Section 11.5(b)."[5] If that put price "exceeds 50% of the tangible assets of the Company," Genitrix must issue notes to the pertinent Class B holders that are payable one-third within thirty days of receipt of the valuation; one-third on the first anniversary of the exercise date of the Put Right; and the balance on the second anniversary of such exercise. In the event of a default by the Company, the Class B Interest holders may replace one of Segal's representatives with an additional Class B representative.[6]

Fisk Ventures has been free to exercise the Put Right ever since September 11, 2001—the fourth anniversary date of the LLC Agreement. The Put Right permits Fisk Ventures, at their sole discretion, to exit their investment in Genitrix—for fair market value—for any reason or for no reason.

Soon after formation, a four-person Board was organized to manage the affairs of Genitrix, with Segal and Johnson each appointing two representatives. The Genitrix Board now consists of five representatives. Under § 7.5 of the LLC

[4] LLC Agreement, § 11.5(b), Ex. 1.
[5] LLC Agreement, § 11.5(c), Ex. 1.
[6] *Id.*

Agreement, the Genitrix Board can only act pursuant to approval of 75% of its members, whether by vote or by written consent.

Segal was originally appointed as both President and Chief Executive Officer of Genitrix. Segal ceased to be CEO of the Company in March 2006, but continues to serve as President.

Only a handful of Board meetings have been held over the entire course of Genitrix's existence. Segal maintains that § 7.5 of the LLC Agreement contemplates that Genitrix's Board can operate by written consent without a meeting, provided that the requisite 75% of the representatives approve such action. Segal and his appointees declined to attend Board meetings from about September 2006 until July 2008, requesting instead that the Board conduct business by e-mail. Segal and the Class B representatives held a two-hour board meeting by telephone on August 5, 2008.

II. ANALYSIS

1. *Standard of Review*

Judgment on the pleadings is appropriate when accepting as true the nonmoving party's well pleaded facts, "'there is no material fact in dispute and the moving party is entitled to judgment under the law.'"[7] The Court will draw all

[7] *In Re Seneca Investments, Inc.*, C.A. No. 3624-CC, 2008 WL 4329230, at *2 (Del Ch. Sept. 23, 2008) (quoting *Warner Commc'ns, Inc. v. Chris-Craft Indus. Inc.,* 583 A.2d 962, 965 (Del. Ch.

reasonable inferences in favor of the nonmoving party and "[t]he nonmoving party must therefore be accorded the same benefits as a plaintiff defending a motion under [Court of Chancery] Rule 12(b)(6)."[8]

2. *Freedom of Contract and Limited Liability Companies*

"Limited Liability Companies are creatures of contract, 'designed to afford the maximum amount of freedom of contract, private ordering and flexibility to the parties involved.'"[9] Delaware's LLC Act thus allows LLC members to "'arrange a manager/investor governance relationship;' the LLC Act provides defaults that can be modified by contract" as deemed appropriate by the LLC's managing members.[10] The LLC Act explicitly states that "[i]t is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements."[11]

Genitrix's LLC Agreement provides that the Company "shall be dissolved and its affairs wound up only on the first to occur of the following: (a) the written consent of Members holding at least 75% of the Membership Interests, voting as

---

1989), *aff'd,* 567 A.2d 419 (Del. 1989)); *see also Desert Equities, Inc. v. Morgan Stanley Leveraged Equity Fund, II, L. P.,* 624 A.2d 1199, 1205 (Del. 1993).

[8] *In Re Seneca Investments, Inc.*, 2008 WL 4329230, at *2.

[9] *R & R Capital, LLC v. Buck & Doe Run Valley Farms, LLC*, C.A. No. 3803-CC, 2008 WL 3846318, at *4 (Del. Ch. Aug. 19, 2008) (quoting *TravelCenters of Am., LLC v. Brog,* C.A. No. 3516-CC, 2008 WL 1746987, at *1 (Del. Ch. Apr. 3, 2008)).

[10] *R & R Capital, LLC v. Buck & Doe Run Valley Farms, LLC*, C.A. No. 3803-CC, 2008 WL 3846318, at *4; *see* Myron T. Steele, *Judicial Scrutiny of Fiduciary Duties in Delaware Limited Partnerships and Limited Liability Companies,* 32 DEL. J. CORP. L. 1, 5 (2007).

[11] 6 *Del. C.* § 18-1101(b).

provided in § 3.5; and (b) the entry of a decree of judicial dissolution of the Company under Section 18-802 of the Act."[12] Segal, as the controlling member of Genitrix's Class A membership interest, opposes dissolution. Since the managing members are hopelessly deadlocked to the extent that 75% of the membership interest in Genitrix will not be voted in favor of dissolution, the only other opportunity for members seeking dissolution would be through a decree of judicial dissolution in accordance with the LLC agreement.

3. *Standard for Dissolution of a Limited Liability Company*

The Court of Chancery may decree judicial dissolution of a Delaware limited liability company "whenever it is not reasonably practicable to carry on the business in conformity with a limited liability company agreement."[13] Section 18-802 has the "obvious purpose of providing an avenue of relief when an LLC cannot continue to function in accordance with its chartering agreement."[14]

In interpreting § 18-802, this Court has by analogy often looked to the dissolution statute for limited partnerships, 6 *Del. C.* § 17-802.[15] In so doing, the Court has found that "the test of § 17-802 is whether it is 'reasonably practicable' to carry on the business of a limited partnership, and not whether it is

[12] LLC Agreement § 12.1, Ex. 1.
[13] 6 *Del. C.* § 18-802.
[14] *Haley v. Talcott*, 864 A.2d 86, 94 (Del. Ch. 2004).
[15] *In re Silver Leaf, LLC*, C.A. No. 20611, 2005 WL 2045641, at *10 (Del. Ch. Aug. 18, 2005).

impossible."[16] To decide whether to dissolve a partnership pursuant to § 17-802, the courts have historically looked to the "business of the partnership and the general partner's ability to achieve that purpose in conformity with the partnership agreement."[17] For example, in *PC Tower,* this Court found that the relevant partnership agreement stated that the partnership's business purpose was to acquire land in the hope of making a future profit.[18] The Court held that the partnership was unable to carry on its business in a reasonably practicable manner because there was (1) a depressed real estate market, (2) property debt was in excess of value, and (3) uncontradicted evidence of a heavily leveraged property where the rent payments were supposed to be forthcoming from a declared insolvent entity. Thus, because it was no longer reasonably practicable to use the partnership's property "for profit and for an investment," the Court ordered dissolution of the partnership.[19]

Applying the same logic in the limited liability company context, there is no need to show that the purpose of the limited liability company has been

[16] *PC Tower Ctr., Inc. v. Tower Ctr. Dev. Assoc. Ltd. P'ship*, C.A. No. 10788, 1989 WL 63901, at *6 (Del. Ch. June 8, 1989).
[17] *Id.*
[18] *Id.* at 1.
[19] *Id.* at 6.

"completely frustrated."[20] The standard is whether it is reasonably practicable for Genitrix to continue to operate its business in conformity with its LLC Agreement.

The text of § 18-802 does not specify what a court must consider in evaluating the "reasonably practicable" standard, but several convincing factual circumstances have pervaded the case law: (1) the members' vote is deadlocked at the Board level; (2) the operating agreement gives no means of navigating around the deadlock; and (3) due to the financial condition of the company, there is effectively no business to operate.[21]

These factual circumstances are not individually dispositive; nor must they all exist for a court to find it no longer reasonably practicable for a business to continue operating. In fact, the Court in *Haley v. Talcott* found that although the limited liability company was "technically functioning" and "financially stable," meaning that it received rent checks and paid a mortgage, it should be dissolved because the company's activity was "purely a residual, inertial status quo that just happens to exclusively benefit one of the 50% members."[22] If a board deadlock prevents the limited liability company from operating or from furthering its stated business purpose, it is not reasonably practicable for the company to carry on its business.

---

[20] *Id.* at 6; *see also In re Silver Leaf, LLC*, 2005 WL 2045641, at *10.
[21] *In re Silver Leaf*, 2005 WL 2045641, at *11; *Haley v. Talcott*, 864 A.2d 86, 95 (Del. Ch. 2004).
[22] *Haley v. Talcott*, 864 A.2d at 91, 96.

4. *Judicial Dissolution of a Limited Liability Company*

More than sufficient undisputed evidence exists in this case to demonstrate the futility of Genitrix's deadlocked board, the LLC Agreement's failure to prescribe a solution to a potentially deadlocked board, and Genitrix's dire financial straits. For these reasons, and as explained further below, I conclude that it is not reasonably practicable to carry on the business operations of Genitrix in conformity with the LLC Agreement.

a. Genitrix's Board is Deadlocked

Under the LLC Agreement, Genitrix's Board has the exclusive power to manage the business and affairs of the company.[23] The Board is unable to act unless both the Class B and the Class A shareholders agree on a course of action. The LLC Agreement imposes a 75% voting requirement for business issues: "Approval of at least 75% of the Representatives shall be required to authorize any of the actions . . . specified in this Agreement as requiring the authorization of the Board."[24] The LLC Agreement requires the cooperation of the Board's managing members in order to accomplish or overcome any issue facing Genitrix. This type of charter provision, unless a "tie-breaking" clause exists, is almost always a recipe for disaster. In this case, unfortunately, the parties are behaving true to form.

[23] LLC Agreement § 7.1(a), Ex. 1.
[24] LLC Agreement § 7.2, Ex. 1.

Although Genitrix's Board is charged to run the Company, the Board is unable to act and is hopelessly deadlocked. Fisk Ventures and Segal have a long history of disagreement and discord over a wide range of issues concerning the direction and operation of Genitrix. On one of the most important issues facing the Company, the raising and use of operating capital, the Board is unable to negotiate acceptable terms to all involved parties. Additionally, the Board has even been considerably deadlocked over whether to have Board meetings. The parties have a history of discord and disagreement on almost every issue facing the Company. There exists almost a five-year track record of perpetual deadlock. Indeed, concerning the current issue, dissolution, the Board is equally deadlocked.

Given the Board's history of discord and disagreement,[25] I do not believe that these parties will ever be able to harmoniously resolve their differences. Consequently, I conclude that Genitrix's Board is deadlocked and unable to resolve any issue, including the current issue of dissolution, facing Genitrix.

b. Navigating the Deadlock in The LLC Agreement

In examining the four corners of Genitrix's LLC Agreement I conclude that no provision exists that would allow the Board to circumvent the deadlocked

[25] Other examples of deadlock in the undisputed record include: Fisk Ventures Note, Answer ¶¶ 135-44; Fisk Ventures Term Sheet, Answer ¶¶ 154-58; The Tilson Term Sheet, Answer ¶¶ 165-78; the 2006 Buy-Down Proposal, Answer ¶¶ 188-93, and the 2007 Buy-Down Proposal, Answer ¶ 208.

stalemate. The document was negotiated by sophisticated parties engaged in an arm's length negotiation. The product of that negotiation, the LLC Agreement, was carefully drafted in such a way that solved one problem but lead directly to the deadlock now gripping the Company. The provision requiring a 75% vote for Board action was agreed upon by the parties to specifically prohibit board domination by one party over another. The provision has certainly accomplished its intended purpose. Unfortunately, it has also led to a stalemate, and the LLC Agreement on its face provides no means of remedying the situation.

Segal argues that since Fisk Ventures owns a Put Right, provided for in § 11.5 of the LLC Agreement, which allows Fisk Ventures to exit its investment by forcing Genitrix to buy out Fisk Ventures for the fair value of its investment, the LLC Agreement contains a provision that will resolve the Board's deadlock. Segal points to Fisk Ventures' Put Right as a proper "exit mechanism" and as an alternative to judicial dissolution. Under § 11.5, the amount to be paid to the Class B investors is to be determined by an independent valuation. If the price exceeds 50% of the value of Genitrix's tangible assets, they will gain creditor status, giving their holder greater security and a higher priority than they currently have as purely equity members.

Segal ignores the fact, however, that the Put Right contemplated in the LLC Agreement grants its owner an option, to be freely exercised at the will and

pleasure of its holder.[26] Nowhere in § 11.5 or in the entire LLC Agreement does the Company have the right to force a buyout if it considers one of its members belligerent or uncooperative. Fisk Ventures holds the option, not Genitrix. Fisk Ventures negotiated for and obtained the Put Right as consideration for its original investment in Genitrix and it would be inequitable for this Court to force a party to exercise its option when that party deems it in its best interests not to do so. I am not permitted to second guess a party's business decision in choosing whether or not to exercise its previously negotiated option rights.

c. Not Reasonably Practicable to Carry on the Business

As noted previously, Genitrix is in dire financial condition. "The Company has no office, no capital funds, no grant funds, and generates no revenue."[27] Genitrix has survived up to this point on equity and debt investments, and on grants from institutions such as the National Institute of Health. The Company does not have any further source of funding, and no realistic expectation of additional grants or infusions of capital.

Segal argues that one of the major sources of Board contention and deadlock has been Fisk Ventures' unwillingness to allow further capital infusion without significant anti-dilution protections. For this reason alone, Segal argues, Genitrix

[26] Nor does Segal explain how Genitrix would be able to pay Fisk Ventures if it were to exercise its Put Right.
[27] *Fisk Ventures v. Segal*, C.A. No. 3017-CC, 2008 WL 1961156, at *6 (Del. Ch. July 3, 2008).

has been unable to raise additional funds. Segal further contends that if Fisk Ventures is forced to exercise its Put Right then Genitrix will be free to raise funds to effect the buy-back. But again, Segal fails to realize that Fisk Ventures has the right to protect itself against what it perceives as Company actions that would diminish the value of its stake in Genitrix. This Court will not substitute its business judgment for that of Fisk Ventures simply because Segal believes that will be in his best interest.

Additionally, Segal believes that dissolution should be denied because it would destroy any value the Company has preserved in its Whitehead Patent License. As stated above, the Whitehead Agreement is the legal vehicle for the grant of significant patent rights now licensed to Genitrix. Under Article 11 of the Whitehead Agreement, the license is not assignable except "in connection with the sale or transfer of all or substantially all of Genitrix's equity and assets."[28] Segal argues that the Company's members will then lose all of the considerable value of that asset, and Genitrix's own patents, which are subordinate to Whitehead's patent, because a purchaser will not be free to operate without a license from Whitehead. This argument is unconvincing.

First, it appears equally likely that a purchaser could enter into a separate licensing agreement with Whitehead for use of its patent. Alternatively, the terms

[28] Whitehead Agreement, Article 11, Segal Aff., Ex. A.

of the Whitehead Agreement could be renegotiated or altered in the sale negotiations. Second, it is ultimately futile to enter into an operating agreement that on its face is doomed to conflict and deadlock, to become mired in a deadlock for years on issues of financing and operations, and then to demand that the Court force the opposing party in the deadlock to capitulate in order to preserve a fleeting hope that additional financing might become available to help preserve some future potential value in a licensing agreement. That argument leads to the same deadlock that now exists on every issue of this company. The value of the Whitehead Agreement is hotly contested and I am unconvinced that any potential value it theoretically might have could not be accessed through a fair and proper sale of the asset. One thing is certain, however. These parties will never be able to reach agreement on how to dispose of this asset, whatever its potential value.

Finally, Segal's argument that Fisk Ventures cannot seek judicial dissolution because it comes to the Court with unclean hands is without merit. The LLC Agreement is a negotiated contract and Fisk Ventures has the right to attempt to maximize its position in accordance with the LLC Agreement's terms. If Fisk Ventures chooses to exercise its leverage under the LLC Agreement to benefit itself, it is perfectly within its right to do so. Additionally, Segal offers no facts to support his contentions that Fisk Ventures seeks dissolution simply to buy Genitrix's assets at fire sale prices. A party cannot simply allege a conclusory

inequitable action as a last ditch effort to persuade the Court to deny a motion for judgment on the pleadings and to allow that party an opportunity to take discovery.

Ultimately, even if the financial progress of Genitrix is impeded by the deadlock in the boardroom, if that deadlock cannot be remedied through a legal mechanism set forth within the four corners of the operating agreement, dissolution becomes the only remedy available as a matter of law. The Court is in no position to redraft the LLC Agreement for these sophisticated and well-represented parties.

III. CONCLUSION

This case involves a long-lived corporate dispute that resulted in devastating deadlock to Genitrix's Board and the loss of significant value to all involved. Genitrix's Board is hopelessly deadlocked, and the LLC Agreement fails to anticipate that risk by prescribing a solution to the Board conflict. Further, Genitrix has no office, no operating revenue, and no prospects of equity or debt infusion. Because Genitrix's dire financial straits leave the Company with no reasonably practical means to operate its business, I conclude judicial dissolution in accordance with the LLC Agreement is the best and only option for these parties. For the foregoing reasons, I grant the motion seeking judgment in favor of petitioner on the petition for dissolution.

The parties shall confer and agree upon a form of implementing order within twenty days from this date.