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COURT OF CHANCERY
OF THE
STATE OF DELAWARE

DONALD F. PARSONS, JR.
VICE CHANCELLOR

New Castle County Courthouse
500 N. King Street, Suite 11400
Wilmington, Delaware 19801-3734

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John G. Harris, Esq.
Berger Harris, LLC
One Commerce Center, 3rd Floor
1201 North Orange Street
Wilmington, DE 19801

Andrew D. Cordo, Esq.
Ashby & Geddes
500 Delaware Avenue
P.O. Box 1150
Wilmington, DE 19899

Amy Elizabeth Evans, Esq.
Cross & Simon LLC
913 North Market Street, 11th Floor
P.O. Box 1380
Wilmington, DE 19899-1380

Re: *Frank C. Whittington, II v. Dragon Group, LLC*
Civil Action No. 2291-VCP

Dear Counsel:

This Letter Opinion addresses two challenges to an independent accounting following entry of a judgment in favor of Plaintiff, Frank C. Whittington, II. On July 20, 2006, Frank initiated this action seeking recognition as a member of Defendant Dragon Group, LLC ("Dragon Group" or the "Company"). In addition to recognition, Frank also

sought an order compelling an accounting of Dragon Group and an award of his alleged pro rata share of any profits or distributions from the Company.

In an Opinion issued on April 15, 2011 (the "Opinion"), this Court held that Frank owned an 18.81% interest in Dragon Group and was entitled to a judgment of $162,175.10 plus prejudgment interest from Dragon Group and the other members (the "Defendant Members") and an accounting.[1] On May 11, 2011, I entered an order reflecting the ruling made in the Opinion (the "May 11 Order"). Among other things, the May 11 Order called for a final accounting of Dragon Group to determine Frank's proportionate share of any other distributions from the Company beyond those specifically addressed in the Opinion (the "Final Accounting"). The Final Accounting was prepared by an independent accountant, Michael D. Wollaston, of the firm Belfint Lyons & Shuman ("BL&S") and was filed on October 19, 2011. In it, Wollaston concluded that Frank was entitled to an additional net distribution of $396,165.[2] The Final Accounting also determined that Frank should have a capital account with Dragon Group of $7,352.

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1 *Whittington v. Dragon Gp., LLC*, 2011 WL 1457455, at *16 (Del. Ch. Apr. 15, 2011). A more detailed recitation of the facts of this case and the overall dispute between Frank and his siblings that has been the subject of multiple lawsuits in this Court can be found in the Opinion. *Id.* at *1-4.

2 Specifically, the Final Accounting indicated that Frank was entitled to total distributions of $409,096 and was required to make a contribution of $12,931.

Frank raises two challenges to the Final Accounting. First, Frank argues that he is entitled to payment of his attorneys' fees for prosecuting the underlying claims in this action because the Company paid the legal fees the Defendant Members incurred in defending against this action.[3] Second, Frank claims that because the Final Accounting found that Dragon Group had failed to produce proper documentation for the expenditure of $478,000, that amount should be treated as if it were distributed to the Defendant Members and he should be awarded his pro rata share. Because Dragon Group allegedly does not have sufficient assets to cover the anticipated final judgment, Frank also requests that each Defendant Member be made jointly and severally liable for the judgment with the maximum liability for each Defendant Member equal to the aggregate amount of the distributions he or she individually received from the Company.[4]

I address each of Frank's challenges below.

I. Attorneys' Fees

On July 20, 2007, while litigating the substantive claims in this action, the Defendant Members met and authorized Dragon Group to pay legal fees "to defend the members and the LLC against actions attempting to diminish their share and force

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[3] Alternatively, Frank claims that the attorneys' fees paid to the Defendant Members should be treated as a de facto distribution in which he is entitled to participate.

[4] Pl.'s Opening Br. 6.

[Frank] on the LLC as a member" (the "Authorization").[5] Pursuant to this Authorization, Dragon Group paid $798,241 in legal fees for itself and the Defendant Members.

Frank claims that because he ultimately was found to be a member of Dragon Group, the Authorization also entitles him to have Dragon Group pay his attorneys' fees, which amounted to $384,774.61. Alternatively, Frank argues that the payment of the Defendant Members' attorneys' fees by Dragon Group was a de facto distribution and, therefore, he is entitled to his pro rata share of that distribution, *i.e.*, $184,935.49. Defendants contest Frank's contentions, claiming that the Authorization was intended only to cover the attorneys' fees incurred in defense against the action brought by Frank. Defendants further assert that the Authorization was proper under the Limited Liability Company Operating Agreement of Dragon Group, LLC (the "Operating Agreement") and Delaware law.[6]

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[5] Defs.' Opening Br. Ex. A.

[6] For purposes of this Letter Opinion, it remains an open question whether the Agreement in Principle, discussed in the Opinion, or the Operating Agreement is the controlling document in this litigation. In terms of the pending challenges to the Final Accounting, however, both Frank and the Defendant Members argued under the assumption that the Operating Agreement controls. In any case, whether the Agreement in Principle or the Operating Agreement governs, Frank's rights in Dragon Group are immaterial to the resolution of the issues currently before me, because I would arrive at the same conclusion under either agreement. Neither the Agreement in Principle nor the Operating Agreement contains a provision limiting Dragon Group's ability to indemnify its members. Therefore, the Defendant Members' actions would not be prohibited under either governing document.

With regard to whether Frank is entitled to payment of his attorneys' fees in prosecuting this action, I note that the July 20 email from Defendant Thomas D. Whittington, Jr. to the Defendant Members memorializing the Authorization explicitly states that the Authorization was for "legal fees to *defend* the members and the LLC against actions attempting to diminish their share and force [Frank] on the LLC as a member."[7] Based on this description, by one of Dragon Group's managers, and the fact that the Authorization was made in direct response to litigation brought by Frank, I find that the Defendant Members did not intend to include Frank within the scope of the Authorization. Therefore, I reject Frank's contention that he is entitled to his attorneys' fees under the terms of the Authorization.

Under Delaware LLC law, members of an LLC may authorize the payment of attorneys' fees for all or a subset of the LLC's members so long as such action is not contrary to the terms of the LLC's operating agreement.[8] Here, nothing in the Operating Agreement expressly prohibited payment of attorneys' fees in the manner provided in the

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[7] Defs.' Opening Br. Ex. A (emphasis added).

[8] *See* Robert L. Symonds, Jr. & Matthew J. O'Toole, *Delaware Limited Liability Companies* § 11.02[B] (2010) ("A Delaware limited liability company may exercise its power to indemnify or to advance expenses in circumstances where it has no obligation to do so. That is, the limited liability company may provide indemnity or advance expenses, on an *ad hoc* basis, at the discretion of those responsible for deciding such matters on behalf of the company.").

Authorization. Moreover, the Authorization apparently was approved by members of Dragon Group who held a majority interest in the Company during a teleconference at which a quorum of the members was present. Therefore, for purposes of the Final Accounting, the Authorization at least arguably constitutes a valid action by Dragon Group under the terms of the Operating Agreement and, therefore, Delaware law. As a result, I do not consider it appropriate to treat the payments made pursuant to the Authorization as a de facto distribution.

Although I decline to award Frank his attorneys' fees in relation to his challenge to the Final Accounting, it remains possible that Frank might bring a separate claim against Dragon Group or the Defendant Members or managers regarding the propriety of the Authorization and the attorneys' fees paid. As reflected in the May 11 Order, I previously ruled in this action that, notwithstanding Defendants' protestations to the contrary, Frank was a member of Dragon Group at the time of the Authorization.[9] The attorneys' fees Dragon Group paid were incurred in an unsuccessful effort by the Defendant Members to prevent Frank from being recognized as a member.[10] That fact alone, however, does not necessarily make the Authorization improper.

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9 May 11 Order ¶¶ 1-2; *Whittington v. Dragon Gp., LLC*, 2011 WL 1457455, at *16 (Del. Ch. Apr. 15, 2011).

10 Indeed, Tom's July 20 email memorializing the Authorization specifically acknowledges that the Defendant Members were aware that this Court was

In the context of the pending challenges, Frank's claims that he is entitled to receive reimbursement for his attorneys' fees on the same basis as the Defendants Members or that Defendants' actions were wrongful in some respect raise legal and equitable issues that are beyond the limited scope of the Final Accounting. The Final Accounting only was intended to determine Frank's share of profits and distributions made by Dragon Group since 2002. Neither it nor this action in general encompassed issues such as whether the Authorization was outside the scope of Dragon Group's governing documents or in violation of some duty or statute, especially in the sense that it was adopted at a time when Defendants mistakenly were excluding Frank from Dragon Group. Therefore, if Frank wishes to pursue a claim that his exclusion from the Authorization or Defendants' decision to reimburse their own attorneys' fees, but not his, was wrongful, he must do so in a separate action. Accordingly, I dismiss Frank's challenge to the Authorization without prejudice.

II. The Deposits

Frank's second challenge to the Final Accounting relates to two deposits, one for $270,000 (the "First Deposit") and another for $208,000 (the "Second Deposit" and together with the First Deposit, the "Deposits"), resulting from the settlement of certain real estate transactions by Dragon Group in 2005. Wollaston determined that the

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"trending toward granting [Frank] some sort of interest" in Dragon Group. Defs.' Opening Br. Ex. A.

Deposits were received into an escrow trust account for Dragon Group maintained by Whittington & Aulgur, a law firm in which Tom is a partner. Although Dragon Group no longer has the money from the Deposits, the only documentation provided by Dragon Group for the Final Accounting regarding the expenditure of those funds consisted of two handwritten schedules categorizing how the money from the Deposits allegedly was allocated to specific expenses of the Company.

According to the schedule for the First Deposit, money was spent to make payments as follows: (1) for legal fees in the amount of $97,065.53; (2) to Profound Engineering for $24,889.49; and (3) to New Castle County for $8,610.[11] The schedule also reported that the remaining $139,403.45 in the First Deposit erroneously was recognized as income on the books of Whittington, Ltd. in 2002. The schedule for the Second Deposit reports that portions of the $208,000 were spent on legal fees ($10,800) and a mortgage payment to Whittington, Ltd. ($97,200). As with the $139,403.45 from the First Deposit, the remaining $100,000 is reported as erroneously having been recognized as income on Whittington, Ltd.'s books in 2002.

Ultimately, Wollaston concluded that the handwritten schedules were insufficient to show that the Deposits were spent as indicated. In response to that conclusion, Dragon

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[11] The entry for payments to "New Castle County" includes payments to New Castle County, the Delaware State Fire Marshal, and the Delaware Department of Transportation.

Group provided additional backup documentation for the expenses.[12] Having reviewed all the evidence the parties presented to the Court, I find that Defendants failed to sufficiently document the things for which $478,000 from the Deposits allegedly were expended; therefore, Frank is entitled to his share of that unaccounted-for amount.

a. The development expenses

To show the payments made from the escrow trust account to Profound Engineering and New Castle County, Dragon Group provided photocopies of the face side of checks allegedly documenting those payments. The checks were written from Whittington & Aulgur to those entities, but nothing on the face of the checks mentions Dragon Group or the trust account.[13] Furthermore, no invoices, contracts, deposit slips, or other third-party confirmations of the claimed expenditures were introduced into evidence.[14] Because only check faces were provided to the Court, it is impossible to tell whether the checks were canceled by a third-party bank.

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12 *See Dolby v. Key Box "5" Operatives, Inc.*, 1996 WL 741883, at *4 (Del. Ch. Dec. 17, 1996) ("In . . . an action [for an accounting], the Court must rely on the party bearing the burden of proof to come forward with sufficient evidence to allow an accurate accounting based on the record created by the parties.").

13 Hr'g Ex. 5 (Jan. 3, 2012 letter from Jack Harris to Amy Evans regarding additional proof).

14 Tr. 18-19 (David Jennings).

At the January 26, 2012 Hearing (the "Hearing"), Dragon Group's accountant, Laurie Mason, testified that she could provide copies of the backs of the checks at issue to show that they had, in fact, been canceled by a bank.[15] In their post-hearing briefs, Defendants suggest that additional evidence was provided to Frank and BL&S, but no such evidence was submitted to this Court.[16] As a result, the only evidence before the Court documenting the payments to Profound Engineering and New Castle County continues to be the check faces. Because Defendants failed to adduce any third-party confirmation for these transactions, particularly where it is reasonable to infer that such third party confirmation should exist in the form of invoices, contracts, or even just canceled checks, I find that Defendants failed to prove that the disputed funds were spent as they allege.[17]

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15 Tr. 124.

16 At the conclusion of the Hearing, I directed the parties to submit post-hearing briefs and stated that I did not contemplate any further hearing or argument thereafter. In his post-hearing briefs, Frank continued to argue that Dragon Group failed to present adequate documentation to support its allegations regarding the purposes for which the disputed $478,000 was used. Frank did not reference any supplemental documentation provided by Defendants. Defendants also filed post-hearing briefs, and they, too, did not provide the Court with any supplemental documentation.

17 *See Dolby*, 1996 WL 741883, at *4 ("Where the defendants have had ample opportunity to introduce evidence at trial to supplement or contradict the plausible evidence offered by the plaintiffs, but have failed to do so, there is no basis for this Court to question the accounting provided by the plaintiffs.").

b. The attorneys' fees

To prove that certain attorneys' fees related to Dragon Group's business were paid from the First Deposit, Dragon Group provided a spreadsheet breakdown of attorneys' fees totaling $97,065.53. As David Jennings, a representative of BL&S,[18] testified at the Hearing, however, nothing in the spreadsheet indicates how the alleged payments relate to Dragon Group or what legal services were provided.[19] Moreover, Dragon Group did not submit any attorney invoices or other third-party confirmatory evidence to substantiate the entries on the spreadsheet. Instead, again, the only supporting documentation provided by Dragon Group was uncanceled checks from Whittington & Aulgur. Similarly, for the attorneys' fees paid from the Second Deposit, Dragon Group provided the face of a check written to Whittington & Aulgur in the amount of $10,000. Defendants claim this check represents most of the $10,800 allegedly spent from the Second Deposit for legal fees. Because it is impossible to tell from the face of the check whether it ever was canceled by a bank, however, and because neither Defendants nor Whittington & Aulgur introduced any other third-party confirmatory evidence, Defendants failed to meet their burden of proof on this issue.

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[18] At the time of the Hearing, Wollaston was on medical leave from BL&S and unable to testify. Jennings, who also worked on the Final Accounting with Wollaston, testified in his place. Tr. 46-47 (Jennings).

[19] Tr. 33.

Therefore, for the same reasons I found the alleged payments to Profound Engineering and New Castle County to be insufficiently documented, I likewise find that Defendants have not demonstrated that the alleged attorneys' fees payments from both Deposits were made.

c. The mortgage payment

As for the mortgage payment from the Second Deposit, Dragon Group originally provided BL&S with the mortgage and an amortization schedule to support the payment. In the Final Accounting, Wollaston found that this documentation was insufficient to show that the mortgage payment had been made. In response, Dragon Group attempted to document the payment by providing BL&S with general journal entries from Dragon Group and Whittington, Ltd.[20] In an email, Dragon Group's counsel also informed BL&S that it could not find a single check for $97,200, that it assumed that the amount represented a combination of several checks, and that "BL&S should be able to answer this question."[21]

At the Hearing, Jennings testified that, although "when [BL&S] first did the work, [he] didn't understand the transactions at all . . . . once [they] received some additional

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[20] Hr'g Ex. 6. The general journal entry from Whittington, Ltd. allegedly documenting the payment did not identify the payment as coming from Dragon Group or the trust account.

[21] *Id.* at 5.

clarification, [he] understood" that the mortgage payment had been made.[22] Although Jennings did not extensively describe what the additional "clarification" was, he expressed the belief that there was adequate support because Dragon Group's mortgage was credited for the payment.[23] Jennings admitted, however, that he had not seen the books of Whittington, Ltd. and he was not sure the payment ever reached Whittington, Ltd.[24] In addition, Jennings said that he would expect to see a payment of $97,200 on the books and records of Whittington, Ltd.[25] Frank's expert, Sharron Cirillo, testified credibly, however, that she had reviewed the books of Whittington, Ltd. for 2005 and found no entry for a mortgage payment of $97,200. Cirillo went on to state that the amortization schedule provided by Dragon Group did not reflect any discrete mortgage payment to Whittington, Ltd. in the amount of $97,200.

In response to Cirillo's testimony, Dragon Group's Mason claimed that, despite the fact that it had not yet been produced, a check for $97,200 was deposited with

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22 Tr. 38.

23 *Id.*

24 Tr. 45.

25 *Id.*

Whittington, Ltd. and she could provide the canceled check for that amount as proof.[26] No such check was ever made part of the record, however.

Thus, the only additional evidence of the mortgage payment to Whittington, Ltd. is Jennings's testimony and a cryptic general journal entry for Whittington, Ltd. from 2005 for a payment of $97,200. In these circumstances, I find Defendants have failed to carry their burden of proving this transaction occurred. Jennings did not satisfactorily explain why he came to believe that the mortgage payment had been made and he evidently did not rely on any third-party evidence or even the books of Whittington, Ltd. in reaching that conclusion. Moreover, although Jennings, Mason, and Cirillo all agreed that there should have been an entry on the books of Whittington, Ltd. for $97,200, no such entry was ever found. Lastly, Defendants failed to provide the Court with a canceled check for $97,200, even though Mason averred that it existed and could be provided after the Hearing. For all these reasons, I find that Defendants have not shown that the alleged mortgage payment was made.

d. Money transferred to Whittington, Ltd. through accounting errors

Finally, Defendants have failed to present sufficient confirmatory evidence in support of their contention that the remaining $239,403.45 erroneously was recorded as income on the books of Whittington, Ltd. Indeed, Defendants admit that there was

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[26] Tr. 123-24.

insufficient documentation as of the Hearing to support their claim that money from the Deposits mistakenly was transferred to Whittington, Ltd.[27] They now assert, however, that sufficient documentation was supplied to Frank and BL&S following the Hearing. But, Defendants did not submit that information to the Court.[28] Moreover, BL&S has not issued any further opinion or report about the adequacy of Defendants' documentation and Plaintiff still maintains in his post-hearing briefs that Defendants' support for the alleged transactions remains inadequate.[29] Although I am loath to reject Defendants' claims on what is allegedly an incomplete record, Defendants have had multiple

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27 *See* Defs.' Opening Br. 10 ("Thus, as of the Hearing date, the only items lacking sufficient support were (i) Income recognized on LTD's books in 2002 in the amount of ($139,403.45) relating to the first deposit, and (ii) Income recognized on LTD's books in 2002 in the amount of ($100,000.00) relating to the second deposit."). As with the other $238,600, Defendants presented only handwritten notes and uncanceled checks to support the alleged transfer of the $239,403.45 to Whittington, Ltd.

28 *Id.* at 10-11 ("[T]he Court ordered the Company to produce additional support within five days of the Hearing. Defendants complied with this directive, producing all of the outstanding materials relevant to the Accounting, namely copies of cancelled checks, deposit slips and bank statements evidencing the transactions relating to the Deposits."). The Hearing took place on January 26, 2012 and the five-business-day period expired on or about February 2. Both parties filed opening briefs on February 17 and answering briefs on February 24. Thus, Defendants had ample opportunity to bring any additional evidence they considered important to the Court's attention. The opportunity for doing so has now expired.

29 Pl.'s Opening Br. 8; Pl.'s Ans. Br. 3.

opportunities to submit the necessary documentation to this Court and have failed to do so. At this point, I have issued five written opinions in this overly-protracted dispute and devoted extensive time to understanding the detailed record presented. In these circumstances, it would not be equitable or appropriate to afford either side the chance to supplement the record yet again. Therefore, I find that Defendants failed to present sufficient evidence to support their allegations that the remaining $239,403.45 from the Deposits was transferred to Whittington, Ltd.

Because insufficient evidence has been provided to document the expenditure or transfer of the $478,000 from the Deposits, Frank is entitled to his pro rata share of that amount as if it had been distributed to the Defendant Members. Accordingly, because Frank has an 18.81% interest in Dragon Group, he is entitled to an additional distribution of $89,911.80.

III. The Defendant Members' Liability

Finally, Frank requests that each of the Defendant Members be held jointly and severally liable to him with the maximum liability for each Defendant Member being the aggregate amount of the distributions he or she received from Dragon Group. Frank argues that such liability would be equitable because Dragon Group allegedly is unable to pay the full judgment in this action and it would be burdensome for him to sue each of the Defendant Members in different states.

In the Opinion resolving the substantive issues, I addressed the possibility that Dragon Group might be unable to satisfy the full judgment in favor of Frank. In that context, I held that:

> [w]hile collection from Dragon Group would be the preferred outcome, the possibility exists that Frank will be unable to collect from Dragon Group (due, for example, to any undisclosed insolvency or liquidity problems). To ameliorate that risk, I will enter judgment not only against Dragon Group, but also jointly and severally against the remaining Defendants, provided that no Defendant shall be liable for more than the total proportionate amount he or she would have been overpaid plus interest.[30]

This ruling is reflected in the portion of the May 11 Order awarding Frank $162,175.10.

The additional $396,165 discovered through the Final Accounting consists of the same type of distributions as the initial $162,175.10. Because neither side has provided any compelling reason for the Court to deviate from that ruling, I find it appropriate to make Defendants liable for that amount in the same way prescribed in the May 11 Order. Therefore, Dragon Group and the Defendant Members are jointly and severally liable for the additional $396,165, provided that no Defendant Member shall be liable for more than the amount they would have been overpaid had Frank been included in the original distributions. In other words, each of the individual Defendant Members are liable for

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[30] Op. 37-38.

their pro rata share of the $396,165 based on their pro rata interest in the Company before Frank's recognition as a member.[31]

For the remaining $89,911.80 Frank is entitled to receive based on Dragon Group's failure to account for the Deposits, I find it appropriate to treat the missing amount, $478,000, as if it were distributed to the Defendant Members. Therefore, I likewise hold that Dragon Group and the Defendant Members are jointly and severally liable for the $89,911.80, with each individual Defendant Members' liability not to exceed his or her pro rata share of that amount, based on their pro rata share of the Company before Frank's recognition as a member.

IV. Conclusion

For the reasons stated in this Letter Opinion, I find that, in addition to the relief granted by this Court in its Opinion and the related May 11 Order, Frank is entitled to an

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[31] This ruling is consistent with the Opinion and May 11 Order. There, I made the Defendant Members liable for any amounts they would have been overpaid if Frank had been included in the original distributions, plus prejudgment interest. The amount each Defendant Member would have been overpaid is equal to the amount of the distribution owed to Frank multiplied by the Defendant Member's pro rata interest in the Company before Frank's recognition as a member. The table in footnote 93 of the Opinion can be used to derive the pro rata liability of each Defendant Member, excluding Frank's interest. For example, Tom is liable for 21.587% of the $396,165, or $85,520.14.

additional distribution of $486,076.80 from Dragon Group.[32] For the $396,165 in distributions owed to Frank, he is entitled to prejudgment interest calculated in the manner set forth in the supplemental order being entered concurrently with this Letter Opinion. Dragon Group and the Defendant Members are jointly and severally liable for the $396,165 plus interest, with the individual Defendant Members' liability not to exceed the amount they would have been overpaid had Frank been included in the original distributions.

For the remaining $89,911.80, because it is impossible to determine whether and when these sums were distributed and there is a possibility that the distributions, in fact, did not occur and that Frank, therefore, might obtain a windfall due to Dragon Group's poor recordkeeping, I decline to award prejudgment interest on this amount. Dragon Group and the Defendant Members are jointly and severally liable for the amount, with the individual Defendant Members' liability not to exceed their pro rata share of that amount, based on their pro rata share of the Company before Frank's recognition as a member.

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[32] $396,165 + $89,911.80.

A supplemental order consistent with this Letter Opinion is being entered concurrently herewith.

Sincerely,

/s/ Donald F. Parsons, Jr.

Donald F. Parsons, Jr.
Vice Chancellor