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Chancery Court Allows LLC Member to Inspect Books and Records of LLC Subsidiary

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Special to the Delaware Business Court Insider | October 26, 2011

In the Aug. 31 case *DFG Wine Co. LLC v. Eight Estates Wine Holdings LLC*, the Delaware Court of Chancery considered the question of the right of a limited liability company member to inspect the books and records of the company's subsidiary. In this post-trial letter opinion, the court granted an LLC member the right to inspect certain books and records of the company's subsidiary even though neither the Delaware Limited Liability Company Act (LLC Act) nor the LLC agreement expressly give it that right.

DFG Wine Company LLC sought to inspect certain books and records of Eight Estates Wine Holdings LLC under both the right of access in the LLC Act, 6 Del. C. §18-305, and Eight Estates' LLC agreement. Eight Estates' primary asset was Ascentia Wine Estates LLC, a wholly owned subsidiary of Eight Estates and the sole operating entity. DFG served Eight Estates with a written demand for access to 16 categories of records of Eight Estates and Ascentia. DFG's stated purposes for seeking the records were to (1) determine the value of its investment in Eight Estates, and (2) determine whether it should appoint a representative to sit on Eight Estates' board of managers and whom. Eight Estates responded that it would provide the requested records held by it, but that DFG was not entitled to Ascentia's records under the LLC Act or the LLC agreement.

The LLC agreement provided that upon written request, any unit holder was entitled to copies of information required to be maintained by the company pursuant to the LLC agreement and copies of any other data required to be provided under the LLC Act. Section 18-305 of the LLC Act grants members of an LLC the right to demand access to certain of the LLC's books and records for any purpose reasonably related to the member's interest, provided the demand is in writing and states the purposes for which the information is sought. Section 18-305(c), however, provides that the LLC has the right to keep confidential from its members any information that the company's manager "reasonably believes to be in the nature of trade secrets or other information the disclosure of which the manager in good faith believes is not in the best interest of the limited liability company or its business."

The court first concluded that DFG had stated proper purposes for its demand. Determining what its investment in Eight Estates was then worth and whether to appoint someone to the company's board of managers (and whom) were both proper purposes. The key question was whether DFG was entitled to inspect the books and records of the company's subsidiary, Ascentia, since the valuation of DFG's interest in Eight Estates depended entirely on the value of the subsidiary company.

After noting that the right of LLC members to inspect the books and records of an LLC's subsidiaries is not explicit in 6 Del. C. §18-305, the court nevertheless acknowledged that Delaware courts have recognized a right to inspect the records of such subsidiaries pursuant to the LLC Act where the "facts at least suggested the absence, in reality, of separate entities." The court pointed out that the amendments to the Delaware Corporation Law at 8 Del. C. §220(b)(2), granting stockholders the right to inspect a subsidiary's books and records after the amendment's Aug. 1, 2003, effective date, did not affect the rights of LLC members to inspect the books and records of their company's subsidiaries where "those subsidiaries [are] under the full control of the parent and the 'value' of the subsidiaries accrue[s] to the parent."

In the case of DFG's demand, the court found that Ascentia was Eight Estates' sole asset and was wholly owned by it. Therefore, Ascentia's value accrued to Eight Estates and Eight Estates had no value apart from Ascentia's. Moreover, Ascentia had no separate board of managers, but was managed by Eight Estates, which was its sole member. The two entities shared the same address, and Eight Estates had no budget, business plan or projections apart from those of Ascentia. Under the circumstances, the court concluded it would be unfair to require a member of Eight Estates to attempt to value its holdings without providing access to the records of the company's only asset. Because the LLC agreement entitled DFG to receive copies of any books and records to which it would be entitled under the Delaware LLC Act, DFG was entitled to inspect the subsidiary's records.

In reaching its decision, the court distinguished a prior case in which an LLC member was denied access to the book and records of companies in which the LLC had invested. In the 2002 case *Arbor Place LP v. Encore Opportunity Fund LLC*, the court refused to allow a member of two "feeder funds" to inspect the books and records of the funds in which they invested because they were separate and distinct from the feeder funds. There, the court found that there was a legitimate business purpose for the separate existence of the funds, each of the funds had a separate and functioning board of directors that was not controlled by the feeder funds, and each of the funds had a significant shareholder other than the feeder funds. Such was not the case with Eight Estates and its subsidiary, Ascentia.

Eight Estates also invoked the protections of Section 18-305(c) and contended that disclosing certain information to DFG was not in the best interests of the company. One of the company's managers testified to his belief that, because DFG had previously alleged that Eight Estates was insolvent and DFG had sought permission to inform the company's creditors of those views and to dissolve the company, it was not in the company's best interests to divulge details of its relations and conversations with creditors of the company or its subsidiary. The court agreed, and held that the company need not divulge such information to DFG. The court held that the protections of Section 18-305(c) did not apply to other information "more tenuously related to Ascentia's relationship with its creditors," such as its financial statements, and Eight Estates would be required to disclose them to DFG. The court also held that Eight Estates could redact information that it reasonably

believed to be in the nature of trade secrets and it did not have to make such information available to DFG.

Unlike the General Corporation Law, which gives stockholders the express right to inspect a subsidiary's books and records, the LLC Act does not give limited liability company members the express right to access information in the books and records of the company's subsidiary. However, as *DFG* shows, the courts are not without power to allow such access in the appropriate case. Here, then, a toast to DFG Wine Co.

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