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IN THE SUPREME COURT OF THE STATE OF DELAWARE

DV REALTY ADVISORS LLC, Defendant Below, Appellant, v. POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO, ILLINOIS, et al., Plaintiffs Below, Appellees, and DV URBAN REALTY PARTNERS I, L.P., Nominal Defendant Below, Appellee.	§ § § § § § § § § § § § § § § § § § § §	No. 464, 2016 On Appeal from the Court of Chancery of the State of Delaware, C.A. No. 7204

OPENING BRIEF OF
APPELLANT DV REALTY ADVISORS, LLC

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NATURE OF THE PROCEEDINGS

This appeal has its genesis in the removal without cause (the "Removal") of appellant DV Realty Advisors, LLC ("DV Realty") as the general partner of appellee DV Urban Realty Partners I, L.P. (the "Partnership"). This Court affirmed the Court of Chancery's post-trial decision upholding the Removal.[1] Separately, after trial in the removal action, the parties presented the Court of Chancery with two issues of interpretation of the Partnership's Third Amended and Restated Agreement of Limited Partnership (the "Agreement," Tab 6) arising from the Removal: (i) whether DV Realty became a limited partner as a result of being removed without cause (the "Limited Partner Issue"); and (ii) how to calculate DV Realty's Capital Account for the purpose of the Partnership buying out half of DV Realty's interest in the Partnership, as the Agreement required it do following the Removal (the "Capital Account Issue").

In a letter opinion dated November 27, 2013 (the "Opinion," attached as Exhibit A), the Court of Chancery resolved both issues against DV Realty. DV Realty appeals from these erroneous conclusions.

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[1] *See generally DV Realty Advisors, LLC v. Policemen's Annuity & Ben. Fund*, 75 A.3d 101 (Del. 2013) ("*DV Realty II*"), *aff'g* 2012 WL 3548206 (Del. Ch. Aug. 16, 2012) ("*DV Realty I*").

SUMMARY OF ARGUMENT

I. The Court of Chancery erred in holding that DV Realty became a holder of an "economic interest" in the Partnership rather than a limited partner upon the Removal. In so holding, the Court of Chancery disregarded the tenets of contract interpretation, most notably by failing to give effect to the plain language that the parties selected for the Agreement. Section 3.10(a)(iii) of the Agreement, concerning the consequences of Removal, unambiguously provides that DV Realty is a "Partner" because it maintains a "Capital Account" like that of "any other Limited Partner" and a "Partnership Percentage," which is a Partner's interest in the Partnership. The Court of Chancery's contrary holding disregards that language and instead invents an "economic interest" tier of ownership nowhere referenced in the Agreement. It also renders other provisions of the Agreement inconsistent or superfluous; the only interpretation of the Agreement that gives effect to each of its words is that DV Realty is a limited partner post-Removal. Finally, the Court of Chancery's interpretation fails to carry out the purpose of Section 3.10(a)(iii), which the parties agree was to protect DV Realty's interests post-Removal, by transforming DV Realty's Capital Account into trapped capital that enjoys no equitable or contractual protections.

II. The Court of Chancery erred in holding that the Partnership was permitted to value the Partnership's assets, for the purpose of carrying out its

obligation to cash out half of DV Realty's Capital Account within 30 days of the Removal, using a net fair market value appraisal of the Partnership's assets rather than the tax basis method specified by the Agreement. Notwithstanding the definition of asset value in the Agreement, the Court of Chancery incorrectly held that the Partnership was permitted to "elect" to revalue the assets under two alternative provisions in the Agreement, neither of which speaks to this point. Section 5.14(b) of the Agreement permits the Partnership to make "elections" under treasury regulations for tax purposes. However, the regulation that the Partnership purported to invoke does not authorize it to do anything (much less revalue assets) and, in any event, the regulation's one purpose—determining whether an IRS safe harbor has been established—is irrelevant here. Section 5.11 of the Agreement authorizes the Partnership to adopt "conventions" for determining *when* capital contributions are "deemed received." It does not confer authority to revalue the partnership's assets under the guise of adopting a "convention." Therefore, the Court of Chancery erred by holding that the Agreement permitted the Partnership to revalue DV Realty's Capital Account. The court also erred in holding that the proper date for valuing the Partnership's assets was months after the payment to DV Realty was due.

FACTS

A. Background On the Removal Dispute and Prior Proceeding in this Court

The Partnership is a Chicago-based real estate investment partnership. *DV Realty II*, 75 A.3d at 103. By virtue of an initial investment of $3.4 million in the Partnership, DV Realty owns a 4.9% "Partnership Interest" therein. *Id.*; *DV Realty I*, 2012 WL 3548206, at *1. The remainder of the Partnership Interest is owned by the Partnership's other five limited partners, who were the plaintiffs below (collectively, the "Limited Partners").[2] *DV Realty II*, 75 A.3d at 103.

DV Realty served as the Partnership's General Partner from its inception in 2006 until being removed without cause in early 2012. *See id.*[3] The Limited Partners gave DV Realty notice of the Removal on January 30, 2012, effective immediately, and filed the underlying litigation the next day. *DV Realty I*, 2012 WL 3548206, at *8; Opinion at 10. Under the applicable provision of the

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[2] The Limited Partners are: Policemen's Annuity and Benefit Fund of Chicago, Illinois, Municipal Employees' Annuity and Benefit Fund of Chicago, Laborers' and Retirement Board Employees' Annuity and Benefit Fund of Chicago, Retirement Plan for Chicago Transit Authority Employees' Trust, and Public School Teachers' Pension and Retirement Fund of Chicago.

[3] To be precise, DV Realty served as the managing general partner alongside co-general partner non-party OCCAM-DV LLC ("Occam") until Occam's resignation in 2009. *DV Realty I*, 2012 WL 3548206, at *1. Thereafter, DV Realty was the sole general partner. Occam's role in the Partnership is not relevant to any of the issues raised in this appeal and therefore this brief will refer to DV Realty as the only general partner.

Agreement, the Limited Partners were permitted to remove DV Realty only if they determined in good faith that doing so was necessary in the best interests of the Partnership. *DV Realty II*, 75 A.3d at 107. The primary basis for the Limited Partners' decision to remove DV Realty was its failure, on three occasions, to deliver audited financial statements to the Limited Partners by the deadline established in the Agreement, notwithstanding that having the financial statements issued on time would have resulted in the Partnership's auditor issuing them with a "going concern" qualification. *See id*. at 105, 107.

In a post-trial Memorandum Opinion dated August 16, 2012, the Court of Chancery declared that the Limited Partners had properly removed DV Realty without cause. *See id*. at 106. However, the Court of Chancery denied the Limited Partners' application for attorneys' fees, finding there was no basis to invoke the bad faith exception to the American Rule. *DV Realty I*, 2012 WL 3548206, at *21 & n.138; *see also* Tab 2 at A27 ("I worry here that there is a risk that I was wrong. I found the case probably a lot closer [than the Limited Partners argue it was]").[4] On September 7, 2012, the Court of Chancery entered a partial final judgment under Court of Chancery Rule 54(b) implementing the post-trial opinion and

[4] Citations to the record are found in DV Realty's Appendix, filed with this brief, and are cited using the format "Tab __ at A__."

reserving jurisdiction to decide certain remaining disputes, such as the Limited Partner Issue and the Capital Account Issue. *See* Tab 3 at A31-32.

The prior appeal to this Court centered on the definition of the ambiguous term "good faith" as used in the removal provision of the Agreement. *See DV Realty II*, 75 A.3d at 110. This Court held that the Agreement's good faith standard is "purely subjective" and the Limited Partners had proven they had formed the requisite subjective belief in connection with their decision to remove DV Realty as general partner. *Id*. at 111. Accordingly, on August 26, 2013, this Court affirmed the trial court's decision upholding the Removal. *Id*. at 111-12.

Effective as of September 20, 2012, the Limited Partners elected TCB-Urban LLC as the successor general partner to replace DV Realty (the "Replacement General Partner"). *See* Tab 18 at A148 ¶ 1; Opinion at 10-11; *see also* Tab 6 at A93 § 3.10(b) ("Upon the removal of the General Partners as herein provided, the Limited Partners, by a Majority Vote, may elect one or more new General Partners. . . within 60 days of such event or the Partnership shall be terminated. . .").

B. DV Realty's Capital Account

As a result of the Removal without cause under Section 3.10(a)(ii), the Partnership was obligated to cash out 50% of DV Realty's Capital Account within thirty days of the January 30, 2012 Removal. Tab 6 at A92 § 3.10(a)(iii)(B). Also

as discussed in greater detail below, the Agreement provides a tax basis methodology for calculating a partner's Capital Account and the components thereof. *See* Tab 6 at A77-78, A80-81, A101-02.

On February 27, 2012, just before the 30-day cash out deadline, the Limited Partners provided DV Realty and the Court with a calculation of DV Realty's Capital Account. At that time, the Limited Partners followed the tax basis methodology set forth in the Agreement and concluded, based on the Partnership's most recent unaudited financial statements, that DV Realty's Capital Account balance was $1,164,524. Tab 14 at A139. In January 2013, while the first appeal was still pending, the Partnership delivered to DV Realty a Form K-1 that calculated DV Realty's Capital Account as of December 31, 2011, again using the tax basis methodology mandated by the Agreement, as $2,174,494. Tab 15 at A141 § L.

On January 30, 2013, after this Court had affirmed the Removal in *DV Realty II*, the Partnership sent DV Realty a letter stating that it had "preliminarily calculated" DV Realty's Capital Account to be valued at just $294,000. Tab 16 at A146. In reaching that result, the Partnership ignored the tax basis methodology twice used in previous valuations and required by the Agreement, and instead calculated the Capital Account based on the net appraised value of the

Partnership's assets. Without citing any authority under the Agreement to support its use of this methodology, the Partnership explained that:

> This [$294,000 calculation] is based on DV [Realty]'s 4.9% interest in total Limited Partnership net assets, valued at $6 million. The net asset figure was calculated from the appraised value of each investment asset, less contractual obligations, plus the fair market value of other assets preliminarily calculated per GAAP.

Id. The Partnership's 2013 net asset valuation methodology is referred to as the "Appraisal Method."

In response to a subsequent inquiry from DV Realty, the Partnership identified five provisions of the Agreement as the purported basis for its authority to revalue DV Realty's Capital Account using the Appraisal Method. Tab 17 at A147. The Partnership has not disclosed the Partnership's asset value or the value of DV Realty's Capital Account as of December 31, 2012 calculated using the tax basis method specified in the Agreement.

C. Provisions of the Agreement Relevant To The Limited Partner Issue and the Capital Account Issue

Section 3.10(a)(iii) of the Agreement describes the consequences of removing the general partner without cause, the three pertinent parts of which are discussed in turn.

First:

> In the event of the removal of a General Partner. . . such General Partner shall no longer be entitled to the

> Management Fee, but shall retain 100% of its Capital Account . . . with 50% of such Capital Account . . . being maintained on the same basis as *any other Limited Partner*'s Capital Account, while the other 50% of such Capital Account (including the Carried Interest calculated to the removal date) shall be distributed to such General Partner in cash within 30 days of the date of removal.

Tab 6 at A92 § 3.10(a)(iii)(B)(1) (emphasis added).

Under the Agreement, a "Capital Account" is "an account maintained for each Partner" to which each Partner's own capital contributions and its share of the Partnership's Asset Value, Net Profits, and Net Losses are credited and debited. Tab 6 at A77-78; *see also* Tab 6 at A100-02. The term "Partner" means "a Limited Partner or a General Partner." Tab 6 at A81.

The Agreement defines, and sets forth how to calculate, the components of the Capital Account. "Net Profits" and "Net Losses" are based on the Partnership's "taxable income or loss" in a given year, with certain adjustments based on the tax treatment of the gain or loss. *See* Tab 6 at A80-81. The "Asset Value" of a Partnership asset for Capital Account purposes is its "Basis"—that is, "the adjusted basis from time to time of such asset for federal income tax purposes." Tab 6 at A76-77.

Second, "[s]ubsequent to the date of the removal of a General Partner, the removed General Partner shall not be required to make any further Capital Contributions and shall not be allocated any of the expenses attributable to Projects

acquired subsequent to such date." Tab 6 at A92 § 3.10(a)(iii)(B)(2). In contrast, "each Partner" of the Partnership is ordinarily obligated, subject to certain limitations, to contribute capital to the Partnership pro rata in accordance with its Partnership Percentage in response to a Capital Call from the general partner. Tab 6 at A97-98 § 5.1(a); *see also* LPA at 3 (defining Capital Call). Failure to do so is an act of default, which may result in stripping the defaulting Partner of its rights as a Partner. *See* Tab 6 at A99-100 § 5.5.

The term "Partnership Percentage" is defined as "the amount of [each] Partner's total Capital Commitments as divided by the sum of the Capital Commitments of all the Partners expressed as a percentage. . . . Each Partner shall have and own an undivided interest in the Partnership equal to its Partnership Percentage therein." Tab 6 at A100 § 5.7. "The sum of the Partnership Percentages shall equal 100 percent." *Id.* Sections 5.8, 5.9 and 5.10 of the Agreement provide for Partnership distributions and the allocation of assets, gains and losses among the Partners in accordance with their respective Partnership Percentages. *See* Tab 6 at A100-A102.

Third, the Agreement provides for calculating the Carried Interest—a payment to the General Partner for managing the investment—due upon removal by obtaining three outside appraisals. Tab 6 at A92-93 § 3.10(a)(iii)(C); *see also* Tab 6 at A101 § 5.8(a)(vi) (defining Carried Interest). "Any Carried Interest

retained in the removed General Partner's Capital Account shall increase such General Partner's Partnership Percentage as if the amount so retained constituted an additional Capital Commitment made by such General Partner." Tab 6 at A93 § 3.10(a)(iii)(D). The Agreement includes no other provision for reappraising the removed General Partner's Capital Account upon removal. Rather, the Agreement reiterates that, following the determination of the Carried Interest component of the Capital Account and adjustments to account for non-participation in future Capital Calls, the removed General Partner's Capital Account "shall remain fully subject to the profits and losses of the Partnership to the same extent as any other Limited Partner's Capital Account." Tab 6 at A92-93 § 3.10(a)(iii)(C) (emphasis added).

Thus, under the foregoing provisions of the Agreement, DV Realty, after being removed as General Partner, still has a Partnership Percentage, and as such must be a Partner, albeit one not obligated to answer Capital Calls, and holds a Capital Account "fully subject to the profits and losses of the Partnership to the same extent as any other Limited Partner's Capital Account."

D. The Opinion's Resolution of the Disputed Issues and Procedural History

The parties briefed the Limited Partner Issue and the Capital Account Issue in early 2013. As to the former, the Limited Partners argued that DV Realty became the holder of a "mere economic interest" in the Partnership as a result of the Removal; DV Realty argued that it is a Limited Partner. As to the latter, DV

Realty argued that its Capital Account should be calculated pursuant to the formula dictated by the Agreement as of December 31, 2011 and twice used by the Partnership to value DV Realty's Capital Account; the Partnership argued that the Capital Account should be calculated using the new Appraisal Method as of December 31, 2012. On November 27, 2013, the Court of Chancery issued the Opinion ruling on both issues.

For the Limited Partner Issue, the Court of Chancery held that DV Realty was the holder of an "economic interest" in the Partnership after the Removal. After noting that the Limited Partners had not consented to admit DV Realty as a Limited Partner and that nothing in the Delaware Revised Uniform Limited Partnership Act automatically converted DV Realty into a Limited Partner upon Removal, the Court turned to "consideration of the [Agreement]" to resolve the issue. Opinion at 2-3. The Court concluded that DV Realty had not become a "substitute Limited Partner"—that is, the transferee of another Limited Partner's interests—under the Agreement and, therefore, no provision of the Agreement "expressly establishes a process" by which DV Realty became a Limited Partner. *Id.* at 3 (citing Tab 6 at A111 § 9.2).

The Court of Chancery rejected DV Realty's reading of Section 3.10(a)(iii), regarding the consequences of Removal, including specifically the language stating that post-Removal DV Realty was to hold a Capital Account "maintained on the

same basis as any other Limited Partner's Capital Account," as well as the plain language definitions of the words Partner and Capital Account. *Id.* at 4-6. The Court gave five reasons for its conclusion: (i) "it is unlikely that such a major issue [i.e., the Limited Partner Issue] . . . would be handled through a maze of financial valuation or definitional provisions"; (ii) the provisions of the Agreement on which DV Realty relied in arguing that it is a Limited Partner deal primarily with economic rights; (iii) DV Realty still carries the title of General Partner; (iv) DV Realty is no longer obligated to answer Capital Calls; and (v) the language of the Agreement on which DV Realty relies stems from an unspecified requirement under tax law that a former partner be treated as a partner for tax purposes until its interest is liquidated. *Id.* at 5-6.

The Court of Chancery also observed that "representatives or advisors to the [Limited Partners] have made statements reflecting their understanding that a deposed general partner would become a limited partner." *Id.* at 6. Specifically, four of the Limited Partners testified, through their executive directors, to their understanding that DV Realty was to become a limited partner after the Removal. Tab 5 at A59; Tab 7 at A124; Tab 8 at A127; Tab 9 at A130; Tab 10 at A133. Other of the Limited Partners' representatives said likewise. *See* Tab 5 at A60; Tab 11 at A134; Tab 12 at A135; Tab 13 at A137. The Court of Chancery discounted this evidence because the interpretation of the Agreement, which is

unambiguous, poses solely a question of law and DV Realty did not rely on any of the statements prior to the litigation. Opinion at 6.

As to the Capital Account Issue, the Court of Chancery held that the Partnership was permitted to look to the current net market value of the Partnership's assets for the purpose of valuing DV Realty's Capital Account based on two provisions of the Agreement. First, Section 5.14(b) of the Agreement permits the Replacement General Partner to make "elections" under tax law, and it "elected" to revalue DV Realty's Capital Account under a revenue regulation that the Court of Chancery interpreted as authorizing the Partnership to do so. *Id*. at 7-9 & n.13. Second, the Court of Chancery held that revaluing DV Realty's Capital Account constituted the adoption of a "convention" under Section 5.11 of the Agreement, which permitted the Replacement General Partner to adopt "conventions" for certain specified purposes. *Id.* at 9-10.

The Court of Chancery held the proper date for valuing DV Realty's Capital Account was December 31, 2012, the end of the tax year following the trial confirming the Removal. *Id*. at 11. The Court so concluded by finding that the Agreement "provides no helpful guidance on the timing of the valuation" and therefore "focus[ed]" on "reasonableness" and picking a date that "reflects the economic realities of the Partnership." *Id*. In that regard, the court was influenced by the large spread between the Agreement-calculated value of DV Realty's

Capital Account in 2011 and the lower value determined under the Appraisal Method put forward by the Partnership in connection with the litigation. *See id*.[5]

The Opinion directed the parties to prepare an implementing order. They disputed, however, whether a final order should be entered. On November 24, 2014, the Court of Chancery entered a non-final order, but invited DV Realty to make an application for the entry of a partial final judgment under Rule 54(b). Tab 22 at A213-14; Order (attached as Exhibit B). DV Realty did so. However, the Court denied the motion by letter opinion dated May 28, 2015. *See generally Policemen's Annuity & Ben. Fund v. DV Realty Advisors LLC*, 2015 WL 3465814 (Del. Ch. May 28, 2015). The parties subsequently agreed to the entry of a final order, which the Court entered on August 10, 2016. *See* Dkt. 137 (attached as Exhibit C). This is an appeal from that final order.

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[5] The Court of Chancery held that the Partnership's payment obligation was "stayed" while DV Realty's appeal from the decision upholding its removal was pending, and that payment therefore became due, and interest began to accrue, 30 days after this Court's August 26, 2013 opinion affirming that decision. *Id*. at 13. The Court of Chancery also declined to include Partnership liabilities personally assumed by one of DV Realty's principals in the Capital Account value. *Id*. at 12. DV Realty does not contest either holding for the purposes of this appeal.

ARGUMENT

I. THE COURT OF CHANCERY MISINTERPRETED THE AGREEMENT IN HOLDING THAT DV REALTY IS NOT A LIMITED PARTNER OF THE PARTNERSHIP AFTER BEING REMOVED AS GENERAL PARTNER.

A. Question Presented

Did the Court of Chancery err in holding that DV Realty became the holder of an "economic interest," rather than a Limited Partner of the Partnership, after it was removed as general partner? Tab 5 at A50, A51-62.

B. Standard and Scope of Review

The interpretation of the Agreement poses a question of law, which is reviewed *de novo*. *Osborn v. Kemp*, 991 A.2d 1153, 1158 (Del. 2010).

C. Merits of Argument

The Court of Chancery held, and the parties agree, that DV Realty's status after being removed as general partner is controlled by the Agreement. Tab 4 at A38; Opinion at 3. The parties, moreover, agree that the relevant portions of the Agreement are unambiguous. *See* Tab 4 at A38. While the Agreement does not expressly state that DV Realty became a Limited Partner upon being removed as general partner, the language used in the Agreement demonstrates that such was the parties' intention; no other interpretation gives effect to all of the words of the Agreement or enables its provisions to operate as a seamless whole. The Court of Chancery's contrary interpretation of the Agreement and holding that DV Realty is

the holder of an "economic interest" instead runs afoul of the tenets of contract construction.

"Limited partnership agreements are a type of contract. [This Court], therefore, construe[s] them in accordance with their terms to give effect to the parties' intent." *Norton v. K-Sea Transp. Partners L.P.*, 67 A.3d 354, 360 (Del. 2013). Where, as here, a contract is unambiguous, "a court must determine the intent of the parties from the language of the contract." *Twin City Fire Ins. Co. v. Del. Racing Assoc.*, 840 A.2d 624, 628 (Del. 2003). "Delaware adheres to the 'objective' theory of contracts, i.e. a contract's construction should be that which would be understood by an objective, reasonable third party." *Osborn*, 991 A.2d at 1159 (internal quotations and citation omitted). To that end, words should be given their ordinary and usual meaning, interpreted "in a way that gives effect to every term of the instrument, and that, if possible, reconciles all of the provisions of the instrument when read as a whole." *Counsel of the Dorset Condo. Apts. v. Gordon*, 801 A.2d 1, 7 (Del. 2002). Thus, the contract should be interpreted in such a way as to not render any of its provisions illusory, meaningless, or mere surplusage. *Osborn*, 991 A.2d at 1159.

Section 3.10(a)(iii) of the Agreement erects a structure in which, upon Removal, DV Realty holds a Partnership Percentage and maintains a Capital Account. DV Realty's Capital Account bears the same investment risk as "any

other Limited Partner," albeit with two exceptions: (i) the Partnership was required to buy out 50% of DV Realty's Capital Account within 30 days of the Removal; and (ii) unlike other Limited Partners, DV Realty is not required to participate in future Capital Calls—although the Agreement does not prevent DV Realty from voluntarily contributing when a Capital Call is made—subject to having its interest in the Partnership diluted by Capital Calls in which it does not participate. *See* Tab 6 at A92 § 3.10(a)(iii)(B)(2). Under the Agreement, only a Partner—that is, the General Partner or a Limited Partner—may have Partnership Percentages and Capital Accounts. DV Realty is no longer the General Partner, ergo it is a Limited Partner.

That Section 3.10(a)(iii), the provision of the Agreement dealing with removal without cause, is intended to convert a general partner to a limited partner post-Removal is confirmed by its use of the phrase "as *any other* Limited Partner's Capital Account" in two separate places. *See* Tab 6 at A92-93 § 3.10(a)(iii)(B)(1), (C) (emphasis added). The Agreement must be interpreted to give effect to the parties' use of the word "other": the word "other" shows that DV Realty, like the "others," is a Limited Partner. If the parties had intended that DV Realty be treated like a Limited Partner without actually being one, they would have left out the word "other"—among many other necessary changes to the Agreement—and said

that DV Realty's Capital Account would be maintained on the same basis as that of a Limited Partner, or words to that effect.

The Court of Chancery hand waved the parties' use of the words "as any other Limited Partner" in Section 3.10(a)(iii) as an "infelicitous choice of words" that "does not change the clear intent of the [Agreement]." Opinion at 6. However, the Opinion does not identify any language in the Agreement supposedly evidencing a different intent. That is, there are no words in the Agreement that support the Court of Chancery's interpreting Section 3.10(a)(iii) as meaning anything other than what it says. There is no basis in the Agreement for the court to have disregarded the words that the parties chose, which require that DV Realty is like any other Limited Partner post-Removal, and instead interpret the Agreement as conferring DV Realty with an "economic interest" holder status that is not defined, or even mentioned, anywhere in the Agreement.

The Court of Chancery offered two rationales for disregarding the Agreement's plain language. One rationale was its conclusion that the language treating DV Realty's Capital Account like that of "any other Limited Partner" in Section 3.10(a)(iii) of the Agreement only means that "[s]omeone who holds an interest (not yet liquidated) as a former partner, under the revenue laws, must be treated the same as a partner for tax purposes." *Id*. The Opinion cites neither any provision of the revenue laws, nor any part of the Agreement, nor anything in the

record, in support of that conclusion. Moreover, as discussed above, the plain language the parties chose for Section 3.10(a)(iii) is incompatible with an intent to treat DV Realty as if it were a Limited Partner for a limited purpose without its actually being one.[6]

The other rationale is that it is "unlikely that such a major issue" as the Limited Partner Issue would be addressed through "valuation or definitional provisions" of the Agreement. *Id*. at 5. The Opinion's logic cuts against its conclusion; the outcome it reached is far more unlikely, if not absurd. In addition to contradicting the Agreement's plain language, the Court of Chancery's interpretation of the Agreement creates an "economic interest holder" status of ownership that (i) is not mentioned in (and has no rights under) the Agreement, (ii) runs afoul of the tenets of contract construction, and (iii) creates a host of definitional and practical problems.

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[6] The Opinion is internally inconsistent inasmuch as the Court of Chancery stated in one place that DV Realty is still the Partnership's General Partner "even if its status has been modified." *Id*. at 5. There is no support for that conclusion in the Agreement. The Agreement makes no reference to the existence of a "modified" General Partner status; the Partners are either Limited Partners or General Partners. Nor did any party advocate for this interpretation of the Agreement. Rather, they agreed that DV Realty is not the general partner anymore. This isolated statement should be treated as *dictum* because it contradicts the court's holding that DV Realty is the holder of an "economic interest" rather than a Partner. *Id*. at 6.

First, the court's holding that DV Realty is not a Limited Partner cannot be reconciled with the fact that Section 3.10(a)(iii) of the Agreement states, in more than one place, that, post-Removal, DV Realty has a Partnership Percentage and a Capital Account. The definitions of those terms require that DV Realty actually be a Partner. *See* Tab 6 at A100 § 5.7 (defining "Partnership Percentage" as "[t]he partnership percentage of each Partner . . . . Each Partner shall have and own an undivided interest in the Partnership equal to its Partnership Percentage therein."); Tab 6 at A77 (defining Capital Account to require the holder of such an account to actually be a Partner). Under the Court of Chancery's ruling that DV Realty is not a Limited Partner, either: (i) the Partnership Percentage would have to include the interest of a non-Partner, contradicting the language of Section 5.7 of the Agreement; or (ii) the calculation of the Partnership Percentage would have to exclude DV Realty's interest in the Partnership, contradicting Section 3.10(a)(iii).

The Court of Chancery's interpretation of the Agreement also creates tension between Section 3.10(a)(iii)(C), which provides that DV Realty's Capital Account "shall remain fully subject to the profits and losses of the Partnership to the same extent as any other Limited Partner's Capital Account," and Sections 5.9 and 5.10, which provide that the Partnership's profits and losses are to be allocated "among the Partners" in accordance with a specified waterfall. Neither Sections 5.9 nor 5.10, nor any other part of the Agreement, provides a mechanism for

including non-Partners in the allocation or distributions of profits and losses. Similarly, Section 5.8 of the Agreement provides that distributions, when made, are remitted "to the Partners in proportion to their respective Partnership Percentages," and makes no provision for including a non-Partner in the distribution. In contrast, finding that DV Realty is a Limited Partner, like the "others," allows Sections 3.10(a)(iii), 5.7, 5.8, 5.9 and 5.10 of the Agreement to function seamlessly following their plain language.

Second, the Court of Chancery's interpretation of the Agreement renders the language of Section 3.10(a)(iii)(B)(2) excusing DV Realty from answering future Capital Calls meaningless surplusage. Only Partners have to respond to Capital Calls. *See* Tab 6 at A97-98 § 5.1(a); *see also* Tab 6 at A99-100 § 5.5 (stating that a Partner's failure to participate in capital calls may result in forfeiture of rights as a Partner). If DV Realty were not a Limited Partner post-Removal, then it would be under no obligation to answer Capital Calls; if that were the case, including Section 3.10(a)(iii)(B)(2) in the Agreement would have been superfluous. Instead, inclusion of the language demonstrates that the parties intended that DV Realty not be required to contribute additional capital like the other Limited Partners.

Finally, the parties agree that the Agreement was intended to protect DV Realty post-Removal, *see* Tab 4 at A41, at the point that it no longer controls the Partnership's investment activities. But if DV Realty is not a Limited Partner, and

instead is the holder of an "economic interest" that is undefined in the Agreement, it has no rights and no protections. Fifty percent of its Capital Account remains as a trapped equity investment in the Partnership, with the attendant risk, yet DV Realty would be owed none of the duties and have access to none of the recourses under the Agreement to protect its rights, such as voting rights, access to books and record or derivative suits.

DV Realty's ongoing interest in the Partnership distinguishes this case from *Hillman v. Hillman*, 910 A.2d 262 (Del. Ch. 2006), the case on which the Limited Partners relied for their "mere economic interest holder" arguments below. Tab 4 at A36-37. There, the Court of Chancery confronted a limited partnership agreement that "indisputably [wa]s silent" as to the treatment of a removed general partner. *Hillman*, 910 A.2d at 271. Accordingly, the court turned to the default rules supplied by the Delaware Revised Uniform Limited Partnership Act, as well as equitable principles, to determine what should happen to the removed general partner's capital account. The court held that the erstwhile general partner had been expelled and therefore had no continuing rights as a partner and, as a result, the limited partnership was required to pay the general partner fair value for his economic interest in the partnership. *Id*. at 277. Stated differently, the former general partner was entitled to be cashed out and nothing more because the operative agreement entitled it to nothing more.

In contrast, the Agreement mandates that DV Realty is not the holder of just an economic interest waiting to be cashed out. Unlike the agreement in *Hillman*, the Agreement is not silent as to the consequences of the Removal. And unlike the general partner in *Hillman*, DV Realty has not been expelled from the Partnership; it maintains an equitable, partnership interest, contractually treated like any other Limited Partner. The only interpretation of the Agreement that gives effect to each of its words and makes sense as a cohesive whole is that DV Realty is a Limited Partner post-Removal.

II. THE COURT OF CHANCERY MISINTERPRETED THE AGREEMENT IN HOLDING THAT THE PARTNERSHIP WAS PERMITTED TO VALUE DV REALTY'S CAPITAL ACCOUNT USING THE APPRAISAL METHOD.

A. Question Presented

Did the Court of Chancery err in holding that, under the Agreement, the Partnership was permitted to revalue DV Realty's Capital Account using the Appraisal Method as of December 31, 2012? Tab 20 at A173-85, A188-91.

B. Standard and Scope of Review

The interpretation of the Agreement poses a question of law, which is reviewed *de novo*. *Supra* § I.B.

C. Merits of Argument

As discussed above, the Agreement required the Partnership to cash out half of DV Realty's Capital Account within 30 days of the Removal. Also as discussed above, the Agreement provides that the value of the Capital Account is to be calculated based on the Partnership's Asset Value, which is the adjusted tax basis of its assets, and its Net Profits and Net Losses, which are derived from its taxable income, gain and loss. *See supra* at 9. Using the tax basis methodology specified in the Agreement, the Partnership calculated DV Realty's Capital Account value to be $2,174,494 as of December 31, 2011, meaning that DV Realty was owed $1,087,247 within 30 days of the Removal. The Court of Chancery erred by holding the Partnership was permitted to recalculate the Partnership's Asset Value:

(1) using a method other than that specified in the Agreement; and (2) as of a date long after the Removal payment came due.

1. The Agreement Requires Determining Asset Value Based on the Assets' Tax Basis.

As a threshold matter, the Agreement speaks specifically to this issue. The "'Asset Value' with respect to any Partnership asset [is] . . . (d) the Basis of the asset in all [] circumstances" other than five enumerated exceptions. Tab 6 at A76. Two of the exceptions permit the Partnership to value a particular asset at its fair market value at the time that that particular asset is contributed by, or distributed to, a Partner. *Id.*, definition of "Asset Value" ¶¶ (a)-(b). The Partnership may also value all of the Partnership assets at their fair market value at the time of:

> (A) the admission of a Partner to, or increase of a Partner's Partnership Percentage in, the Partnership [i] in exchange for a contribution of Capital [ii] if the Partnership determines to make such adjustment at such times;
>
> (B) the distribution of any asset distributed by the Partnership to any Partner as consideration for an interest in the Partnership; or
>
> (C) the liquidation of the Partnership under [Treasury] Regulations Section 1.704-l(b)(2)(ii)(g). . . .

Id. ¶ (c) (line breaks added). None of the circumstances necessary to invoke the exceptions are present here. Thus, the Agreement unambiguously dispenses with

the Partnership's attempt to employ a fair market valuation in connection with cashing out half of DV Realty's Capital Account.

This intent is reinforced by Section 3.10(a)(iii)(C) of the Agreement, which provides for the Partnership obtaining three market appraisals to determine the value of DV Realty's Carried Interest upon Removal. Conspicuously absent is any similar provision relating to revaluation of the Capital Account upon Removal.

The Court of Chancery held the Partnership was permitted to "use a current [net] fair market valuation" based on two alternative provisions of the Agreement. Opinion at 7. Neither authorizes the Appraisal Method, and therefore the Court of Chancery's contrary conclusion was legal error.

a. Agreement Section 5.14(b) and Treasury Regulations Do Not Authorize The Partnership to Utilize the Appraisal Method.

The Court of Chancery first held that the Partnership was authorized to revalue Partnership assets using the Appraisal Method pursuant to the Replacement General Partner's authority under the Agreement to "make, or refrain from making, any elections relating to or affecting the Partnership under the [Internal Revenue] Code [of 1986, as amended]." Opinion at 7-8 (alterations supplied) (quoting Tab 6 at A104 § 5.14(b)). In briefing on the Capital Account Issue, the Partnership represented that it had purported to "elect" to conduct the Appraisal Method revaluation under Treasury Regulation § 1.704(b)(2)(iv)(f), *codified at* 26 C.F.R.

§ 1.704-1(b)(2)(iv)(f) (the "Regulation"). Tab 18 at A149. The Regulation does not apply in these circumstances, and even if it did, it does not have the effect that the Court of Chancery ascribed to it in the Opinion.

The Regulation, and related regulations under Section 704(b) of the Internal Revenue Code (the "Code"), were promulgated to curb abuse, in the tax arena, of the system that allows partnerships to allocate gains and losses among partners in a way that does not necessarily correspond to the partners' economic interests in the partnership.[7] For example, two partners may own a partnership 50/50, but agree to divide the profits and losses 75/25. Such a division has the potential to be a tax avoidance scheme; the Regulation is designed to address that possibility. Although the IRS describes the Regulation as among its most "difficult and complex" to manage, the Regulation can be distilled to a simple essence: "For partnership allocations to be respected [for tax purposes] they must either be made in accordance with the partners' interests in the partnership or they must meet the requirements of the substantial economic effect safe harbor." *Id.* at A198. The specific Regulation subpart relied on by the Partnership specifies the circumstances

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[7] Internal Revenue Service, *Partnership – Audit Technique Guide – Ch. 6 – Partnership Allocation* at 1 (Dec. 2007) (hereinafter, "IRS Partnership Allocation"), *available at* http://www.irs.gov/Businesses/Partnerships/Partnership---Audit-Technique-Guide---Chapter-6---Partnership-Allocations-%28Revised-12-2007%29 (last visited Oct. 4, 2016) (copy attached at Tab 21 at A198-212).

in which a tax allocation may find refuge in that substantial economic effect safe harbor. *See id.*[8]

The Regulation consequently does not authorize a partnership to do anything or "elect" anything; instead, it describes how the IRS will treat partnership actions under particular circumstances. Specifically, the Regulation says that *if* a partnership increases or decreases capital accounts in a certain manner, *then* the IRS will respect the allocation for tax purposes. Thus, the Partnership cannot "elect" to proceed under the Regulation as authority to revalue DV Realty's Capital Account.

Furthermore, the tax treatment of a profit/loss allocation among partners—the sole purpose of the Regulation—is not at issue here. The Partnership has not argued that DV Realty should be allocated any more or any less than 4.9% of the Partnership's gains or losses, nor has the Partnership argued that the allocation structure specified by the Agreement does not faithfully reflect the Partners' actual

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[8] *See also* 26 C.F.R. § 1.704-1(b)(1) ("If the partnership agreement provides for the allocation of income, gain, loss, deduction, or credit (or item thereof) to a partner, there are three ways in which such allocation will be respected under section 704(b) and this paragraph. First, the allocation can have substantial economic effect in accordance with paragraph (b)(2) of this section."); 26 C.F.R. § 1.704-1(b)(2)(iv)(a) ("an allocation of income, gain, loss, or deduction will not have economic effect under paragraph (b)(2)(ii) of this section, and will not be deemed to be in accordance with a partner's interest in the partnership under paragraph (b)(4) of this section, unless the capital accounts of the partners are determined and maintained throughout the full term of the partnership in accordance with the capital accounting rules of this paragraph (b)(2)(iv).").

respective interests in the Partnership. Rather, the parties agree that DV Realty's Partnership Percentage—and, accordingly, its share of the Partnership's value—is 4.9%. *See* Tab 19 at A155; Tab 16 at A146; *DV Realty I*, 2012 WL 3548206, at *1. Indeed, the Partnership concedes that it has *not* revalued any of the Partnership's assets for tax purposes. *See* Tab 19 at A160 ("The fair market value of the Partnership is. . . far less than the capital account balance reported to each partner for tax purposes."). Therefore, the Regulation is irrelevant to the Capital Account Issue.

And even if the Regulation had some application to what the Partnership is trying to do here, the Partnership could not invoke it for several additional reasons. A revaluation of capital accounts under the Regulation will be given effect only if the operative partnership agreement so provides. 26 C.F.R. § 1.704-1(b)(2)(iv)(f) ("A partnership *agreement* may, upon the occurrence of certain events . . ." (emphasis added)). But here, the Agreement does not so provide. Although an entire section of the Agreement is dedicated to "special allocations" and authorizes the Partnership to employ a number of subparts of 26 C.F.R. § 1.704-1 in the event of certain specified circumstances, the particular subpart on which the Partnership relies—1.704-1(b)(2)(iv)—is not among them. *See* Tab 6 at A102-03 § 5.13(a)-(g).

The Opinion also misconstrues the Regulation in holding that "to adjust capital accounts in compliance with [the Regulation], five criteria must be

satisfied." Opinion at 8. Rather than setting forth "requirements" to authorize the revaluation of a capital account, subpart (f) of the Regulation sets forth the criteria the Partnership must satisfy for an otherwise authorized revaluation to be recognized by the IRS. *See supra* n.8. Put simply, satisfying these criteria does not authorize a revaluation of partners' capital accounts; it only means that the IRS will treat an otherwise authorized revaluation as coming within a tax safe harbor.

And even if the Regulation had the effect ascribed to it in the Opinion, the fourth criterion is not satisfied. That criterion states:

> The partnership agreement requires that the partners' distributive shares of depreciation, depletion, amortization, and gain or loss, as computed for tax purposes, with respect to such property be determined so as to take account of the variation between the adjusted tax basis and book value of such property in the same manner as under section 704(c). . . .

26 C.F.R. § 1.704-1(b)(2)(iv)(f)(4). The Court of Chancery held that "as for the fourth requirement, [Section 5.15 of the Agreement] requires that the revaluation take into account any variations between the property's adjusted tax basis and its book value." Opinion at 9 n.13. However—far from "requir[ing a re-computation of] the partners' distributive shares" as the Regulation says—section 5.15 of the Agreement *prohibits* revaluation of the Partnership's assets under Code section 704(c) for purposes of revaluing the Partners' Capital Accounts. *See* Tab 6 at A105.

By its unambiguous language, the Regulation does not apply to this situation, nor does it bestow upon the Partnership any rights that are not contained in the Agreement, nor does it override the express prohibition in the Agreement on affecting Capital Accounts by revaluing Partnership property. There is no tax allocation or IRS safe harbor issue here. Therefore, the Court of Chancery's holding that the Partnership was permitted to employ the Appraisal Method as an "election" under Section 5.14(b) of the Agreement and the Regulation was error and should be reversed.

b. Agreement Section 5.11 Does Not Authorize The Partnership to Utilize the Appraisal Method.

The Court of Chancery next held that the Partnership was authorized to revalue Partnership assets using the Appraisal Method pursuant to Section 5.11 of the Agreement. That section, entitled "Certain Other Determinations by the Managing Partner," states:

> For purposes of calculating Partnership Percentages, Capital Account balances, calculating and allocating Partner Guaranteed Payments, the allocation of income and loss and distributions, and for all other purposes, *all timely Capital Contributions shall be deemed to have been made on the same day and the Managing Partner shall be permitted to adopt reasonable conventions for such purposes* and any such determination by the Managing Partner shall be final and binding on the Partners. Capital Accounts will not be adjusted by de minimis contributions or distributions of cash or other property.

Tab 6 at A102 (emphasis added). The Court of Chancery held, without elaboration, that "[a]djusting values to fair market value constitutes a reasonable convention. In light of the steep drop in the value of the Partnership assets, such a revaluation is especially appropriate." Opinion at 10.

In effect, this holding ignores the specific provisions of the Agreement that govern how: (i) Partnership Percentages are calculated; (ii) Capital Account balances are calculated; (iii) Partner Guaranteed Payments are allocated; and (iv) income, loss and distributions are allocated. Tab 6 at A77, A81, A100-04 §§ 5.7-5.10, 5.13(b), (j). Section 5.11 was not intended to, and does not, confer such sweeping authority to rewrite the express terms of the Agreement.

Instead, Section 5.11 of the Agreement addresses just one issue: determining the date on which a Capital Contribution is deemed to have been made for the purposes of making certain calculations and allocations. The statement in Section 5.11 that "the Managing Partner shall be permitted to adopt reasonable conventions for such purposes" modifies only the immediately preceding phrase, "all timely Capital Contributions shall be deemed to have been made on the same day." Tab 6 at A102. There is no issue with the *timing* of a Capital Contribution here. Section 5.11 is therefore irrelevant.[9]

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[9] The Opinion offers no explanation for its conclusion that rejecting the Capital Account formula in the Agreement in favor of the Appraisal Method is a

2. The Agreement Requires Valuing DV Realty's Capital Account Contemporaneously with the Removal.

In accordance with the requirement that DV Realty have been paid 50% of its Capital Account within 30 days of the Removal, the amount due to DV Realty should be determined by reference to the valuation of its Capital Account as of December 31, 2011, the end of the tax year immediately preceding the Removal, consistent with the Court of Chancery's determination that "the valuation should be near the date of termination" of DV Realty as General Partner. Opinion at 11. However, the Court of Chancery held that the operative valuation date should be the end of the 2012 tax year. *Id.* That holding was in error.

As a practical matter, December 31, 2012 cannot be the right date to use because the Agreement required the Partnership to pay DV Realty half of its Capital Account balance by 30 days after the January 31, 2012 Removal. The Limited Partners acknowledged this obligation in February 2012. *See* Tab 14 at A138. At the latest, the effective date was October 7, 2012: 30 days after entry of the order confirming the effectiveness of the Removal. Tab 3 at A30-32. Obviously, although the Agreement does not specify the date to use, the correct calculation date cannot be two months after the payment was due.

"convention" at all. *See* BLACK'S LAW DICTIONARY 269 (2000 ed.) (defining convention as "3. A generally accepted rule or practice; usage or custom.").

Two factors erroneously influenced the Court of Chancery's contrary conclusion. The first is that the parties litigated the Removal. *See* Opinion at 11 ("DV Realty did not go upon receiving [the Removal] notice. Instead, the [Limited Partners] concluded that this litigation should be commenced."). The interpretation of the Agreement should not be affected by DV Realty's subsequent contesting of the Removal, in good faith, in litigation described as a "close" case, Tab 2 at A27, and which raised a then-open, evolving issue of Delaware law. *See DV Realty II*, 75 A.3d at 106-07. Moreover, even if the fact of the litigation were relevant to the interpretation of the Agreement, the Removal was confirmed, and the Replacement General Partner had been installed, by October 7, 2012.

The other factor is the Court of Chancery's conclusion that it would be unreasonable to value DV Realty's Capital Account as of prior to the Removal because, according to the court, the Partnership's asset value had subsequently declined. *See* Opinion at 10, 11. However, the court's assumption that the asset value had declined between 2011 and 2012 is not based on an apples-to-apples comparison. The 2011 Capital Account valuation in the record is based on the tax basis method set forth in the Agreement; the 2012 valuation is based on the Appraisal Method, which subtracted debt from the asset value determined by an appraiser hired by the Replacement General Partner. There is no evidence in the

record as to what the Appraisal Method asset value was in 2011, or what the tax basis valuation under the Agreement would have been in 2012.

On both scores, the Court of Chancery's use of developments years after the Agreement was struck to interpret its language *post hoc* was erroneous. "Courts generally must interpret a contract so 'as to give effect to the mutual intention of the parties as it existed *at the time of contracting*. . . .'" *Intel Corp. v. Am. Guarantee & Liab. Ins. Co.*, 51 A.3d 442, 446 (Del. 2012) (emphasis added) (internal citation omitted). There is no basis in contract law to interpret the Agreement based on the fact that litigation was filed or the Partnership's subsequent adoption of a new—and for the reasons discussed above, improper—valuation methodology.

Moreover, using December 31, 2012 as the calculation date would defeat the purpose of the payment due after Removal. The purpose of Section 3.10(a)(iii)(B)'s requirement that the Partnership pay DV Realty half of its Capital Account 30 days after a without cause removal is that it allows DV Realty to get half of its investment out of the Partnership shortly after the Partnership begins operating under new management. Using a calculation date well after the Removal is contrary to the purpose of Section 3.10(a)(iii)(B) because it saddles DV Realty's Capital Account with months of decisions made by the Replacement General

Partner. Thus, the Opinion's conclusion that December 13, 2012 should be used as the calculation date should be rejected.

CONCLUSION

For the foregoing reasons, DV Realty respectfully requests that this Court reverse the Opinion and hold that: (i) DV Realty became a Limited Partner of the Partnership after the Removal; and (ii) the Partnership was not permitted to revalue DV Realty's Capital Account using the Appraisal Method, and instead the Capital Account should be valued in accordance with the Agreement as of December 31, 2011 at $2,174,494.

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CERTIFICATE OF SERVICE

I hereby certify that, on October 24, 2016, a copy of the foregoing *Opening Brief of Appellant DV Realty Advisors, LLC* was caused to be served upon the following counsel of record by File & Serve*Xpress*.

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