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IN THE SUPREME COURT OF THE STATE OF DELAWARE

VILLAGE PRACTICE MANAGEMENT COMPANY, LLC,	)	
Defendant Below, Appellant,	)	No. 232, 2024
v.	)	
RYAN WEST,	)	Court Below: Court of Chancery of the State of Delaware, C.A. No. 2022-0562-MTZ
Plaintiff Below, Appellee.	)	

APPELLANT'S SUPPLEMENTAL MEMORANDUM REGARDING *LKQ CORPORATION V. RUTLEDGE* DECISION

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

PRELIMINARY STATEMENT 1

I. *LKQ* SUPPORTS ENFORCEMENT OF THE FORFEITURE PROVISIONS AS WRITTEN 3

II. THERE IS NO BASIS TO EXCUSE WEST FROM HIS AGREEMENT 8

CONCLUSION 11

TABLE OF AUTHORITIES

Page(s)

Cases

Andaloro v. PFPC Worldwide, Inc.,
2005 WL 2045640 (Del. Ch. Aug. 19, 2005) 10

Cantor Fitzgerald, L.P. v. Ainslie,
312 A.3d 674 (Del. 2024) 2, 3, 4

Fisk Ventures LLC v. Segal,
2008 WL 1961156 (Del. Ch. May 7, 2008) 3

Ford Motor Co. v. Earthbound LLC,
2024 WL 3067114 (Del. June 20, 2024) 2

Henson v. Sousa,
2015 WL 4640415 (Del. Ch. Aug. 4, 2015) 3

Kuroda v. SPJS Hldgs., LLC,
971 A.2d 872 (Del. Ch. 2009) 3

Leaf Invenergy Co. v. Invenergy Renewables LLC,
210 A.3d 688 (Del. 2019) 6

LKQ Corp. v. Rutledge,
96 F.4th 977 (7th Cir. 2024) 8

LKQ Corporation v. Rutledge,
-- A.3d --, 2024 WL 5152746 (Del. Dec. 18, 2024) ..... *passim*

Reid v. Thompson Homes at Centreville, Inc.,
2007 WL 4248478 (Del. Super. Nov. 21, 2007) 6

Soleimani v. Hakkak,
2024 WL 1593923 (Del. Ch. Apr. 12, 2024) 9

Touch of It. Salumeria & Pasticceria, LLC v. Bascio,
2014 WL 108895 (Del. Ch. Jan. 13, 2014) 3

TravelCenters of Am., LLC v. Brog,
2008 WL 1746987 (Del. Ch. Apr. 3, 2008) 3

Rules & Statutes

Del. Supr. Ct. R. 12 7

PRELIMINARY STATEMENT

This Court's recent decision in *LKQ* reinforces why the Court of Chancery's judgment should be reversed. *LKQ Corporation v. Rutledge*, -- A.3d --, 2024 WL 5152746 (Del. Dec. 18, 2024). The opinion confirms that forfeiture-for-competition provisions are enforceable outside of the partnership context and regardless of whether the provision requires the return of "benefits already received." *LKQ*, 2024 WL 5152746, at *5. Those holdings are significant because Appellant is a limited liability company, and because West's Award Agreements require the return of "***all*** the Class B Units, ***vested and unvested***" if West engages in Detrimental Activity. (Award Agreements § 4(a) (emphasis added.)). West's arguments to the contrary are mistaken. *See, e.g.*, Tr. at 22 (arguing that the forfeiture-for-competition provision in this case is unenforceable because West's Class B Units have already vested). Consistent with this Court's teachings in *LKQ*, Delaware law should respect the express bargain reflected in the Award Agreements and Plan—*i.e.*, that all vested and unvested Class B Units are forfeited if West engages in Detrimental Activity.

If anything, the grounds for holding West to his bargain are stronger than those in *LKQ*. There, a public corporation sought to claw back proceeds from ***eight years of open-market sales of vested stock*** rather than the cancellation of equity units in a limited liability company governed by the LLC Act's express freedom-of-contract provisions. (*See* Opening Br. at 33; *LKQ*, 2024 WL 5152746, at *4 (noting reliance

on analogous DRULPA freedom-of-contract provisions in *Cantor Fitzgerald, L.P. v. Ainslie*, 312 A.3d 674, 691-92 (Del. 2024).) There is nothing problematic about enforcing an express, freely-executed contractual bargain that if an executive joins a competing business, he may not continue as an LLC unitholder and may not retain a benefit that was intended to keep his interests aligned with the LLC's.

The Court should thus reverse the Court of Chancery's judgment.[1]

[1] *See Ford Motor Co. v. Earthbound LLC*, 2024 WL 3067114, at *13 (Del. June 20, 2024) (judgment on the pleadings improper when contractual provisions "have multiple reasonable interpretations").

I. *LKQ* SUPPORTS ENFORCEMENT OF THE FORFEITURE PROVISIONS AS WRITTEN

In *LKQ*, this Court endorsed a "broad" reading of the freedom-of-contract and employee-choice principles upheld in *Cantor Fitzgerald v. Ainsley*. (*See LKQ*, 2024 WL 5152746, at *4 (citing *Cantor Fitzgerald*, 312 A.3d 674, 688 (Del. 2024).) *Cantor Fitzgerald*, in turn, highlighted DRULPA's "emphatic policy statement" to give "maximum effect to the principle of freedom of contract," which is repeated nearly verbatim in the LLC Act. (*See Cantor Fitzgerald*, 312 A.3d at 688; Opening Br. at 33.) Courts routinely describe LLCs as "creatures of contract" and have long emphasized that LLC-related agreements should ordinarily be enforced as written.[2]

As held in *Cantor Fitzgerald* and confirmed in *LKQ*, "'courts do not review forfeiture-for-competition provisions for reasonableness so long as the employee voluntarily terminated her employment.'" (*See LKQ*, 2024 WL 5152746, at *5 (citing *Cantor Fitzgerald*, 312 A.3d at 684.) West admits that he resigned voluntarily

[2] *See, e.g., TravelCenters of Am., LLC v. Brog*, 2008 WL 1746987, at *1 (Del. Ch. Apr. 3, 2008); *accord, e.g., Henson v. Sousa*, 2015 WL 4640415, at *1 (Del. Ch. Aug. 4, 2015) ("LLCs, as this Court has repeatedly pointed out, are creatures of contract."); *Touch of It. Salumeria & Pasticceria, LLC v. Bascio*, 2014 WL 108895, at *4 (Del. Ch. Jan. 13, 2014) ("[R]ecognizing that LLCs are creatures of contract, I must enforce LLC agreements as written."); *Kuroda v. SPJS Hldgs., LLC*, 971 A.2d 872, 880 (Del. Ch. 2009) ("Limited liability companies are creatures of contract...."); *see Fisk Ventures LLC v. Segal*, 2008 WL 1961156, at *8 (Del. Ch. May 7, 2008) ("In the context of limited liability companies, which are creatures ... of contract, those duties or obligations [among parties] must be found in the LLC Agreement or some other contract." (footnote omitted)).

from VPM. (*See* Compl. ¶ 19.) The Court should enforce West's forfeiture agreements as written with no special interpretive indulgences in West's favor.

LKQ further emphasized, as did *Cantor Fitzgerald*, that honoring express forfeiture conditions for equity grants serves the interests of both employees and employers without raising the same policy concerns as traditional covenants not to compete. As this Court observed, "[b]usiness entities would be discouraged from offering employees additional benefits if we did not respect their contracts" and must take care to ensure that granting the awards serves the company's interests. (*See LKQ*, 2024 WL 5152746, at *5 (citing *Cantor Fitzgerald*, 312 A.3d at 691).) A right to forfeiture likewise does not allow LLCs to enjoin former employees from working elsewhere, but simply excludes the employee from the conditional benefit of continued membership in the old business after joining a competitor. (*See id.*)

Echoing the Court's policy discussion in *LKQ*, the Plan and Award Agreements contain provisions designed to ensure the granting of Class B Units serves VPM's interests as well as West's. The Plan's opening paragraph states that the purpose of granting Class B Units to employees is "to further the growth and success of" VPM by "increasing [the recipients'] personal interest in such growth and success" in addition to "rewarding outstanding service by such persons" to VPM. (Plan § 1.) When an employee voluntarily departs VPM and joins a competitor, however, VPM no longer has an interest in continuing to promote the

employee's "personal interest" in VPM's growth, nor does it serve the interests of VPM's other unitholders to have their equity diluted by a former employee who is now competing with the business (or to have a now-competing former employee otherwise maintain his rights as an LLC unitholder). It is thus sensible and unsurprising that the units would terminate upon joining a competitor—a restriction fully consistent with Delaware law. Indeed, allowing West to keep his Class B Units under these circumstances or requiring a market-value buyout would correspondingly dilute or diminish the value of Class B Units held by employees who did not leave VPM and join a competitor.

LKQ also makes clear that the Court should not superimpose artificial distinctions between the "vested" or "unvested" nature of the benefit, or the time periods before and after termination, when interpreting the relevant contractual provisions. As emphasized in *LKQ*, "[t]he fact that the LKQ RSU Agreements require the return of benefits already received does not alter our analysis." (*See LKQ*, 2024 WL 5152746, at *5.) What matters instead is what the relevant agreements actually say. (*See id.* (citing *W.R. Berkley Corp. v. Hall*, 2024 WL 511040 (3rd Cir. Feb. 9, 2024) (enforcing stock clawback provision "as a bargained-for provision in agreements struck by sophisticated parties").)

Once again, the Award Agreements and Plan simply do not say—and should not be unnaturally construed to say in *LKQ*'s wake—that vested units are immune

from forfeiture after termination of employment and are only subject to repurchase rights. The Award Agreements state the opposite: that "[i]n the event of the Participant's Termination of Service for Cause ***or upon the Participant's commission of a Detrimental Activity, all the Class B Units, vested and unvested, shall immediately terminate and be forfeited*** without payment therefore." (Award Agreements § 4(a) (emphasis added); *accord*, Plan § 8(b).) Nothing in the Awards Agreement or Plan says that repurchase rights are the exclusive right available to VPM after termination of employment.[3] There is no time limit or "continued employment" condition in the Award Agreements' definition of "Participant," which is a defined term meaning simply "the participant identified on the cover page" of that agreement. (Award Agreements, p. 1.) And, as previously noted, the Plan and Awards Agreements repeatedly use the term "Participant" to refer to the Class B Units recipient after their employment—provisions that would make no sense if

[3] Delaware courts again do not read exclusivity into contractual remedies when not expressly specified. *See, e.g., Leaf Invenergy Co. v. Invenergy Renewables LLC*, 210 A.3d 688, 704 n. 54 (Del. 2019) ("Nothing in [the applicable provision] provides that it was the sole or exclusive remedy"); *Reid v. Thompson Homes at Centreville, Inc*., 2007 WL 4248478, at *5 (Del. Super. Nov. 21, 2007) ("[E]ven if a contract specifies a remedy for breach of that contract, a contractual remedy cannot be read as exclusive of all other remedies if it lacks the requisite expression of exclusivity"). Here, not only is there no exclusivity language in the repurchase rights provisions, but the forfeiture provisions expressly contradict any notion of exclusivity by providing that forfeiture occurs "upon the Participant's commission of a Detrimental Activity," with no time limit. (*See* Award Agreements § 4(a).)

West were no longer a "Participant" after termination of employment. (*See* Opening Br. at 15-18, 26-29; Reply at 5-10.) It likewise makes no sense to limit "Detrimental Activity" to only the activities of a current employee when "Detrimental Activity" expressly includes breaches of a "severance agreement" and other conduct that would naturally occur post-employment. (*See* Opening Br. at 25-26; Reply at 10.)

In sum, the Award Agreements and Plan do not limit forfeiture to pre-termination "Detrimental Activity," nor do they make repurchase the sole remedy after conclusion of employment. *LKQ* confirms that courts should enforce forfeiture-for-competition clause to the same extent and on the same basis as other bargains. Just as *LKQ* rejects artificial distinctions between unpaid benefits and "benefits already received," the contractual provisions at issue here reject West's artificial distinctions between pre-termination and post-termination conduct, and between vested and unvested units. Requiring VPM to allow a now-competing former employee to retain their units would violate the parties' express bargain, reduce the willingness of LLCs like VPM to make equity grants, and undermine the ability of LLCs to protect themselves (and their remaining equity holders) from the adverse effects of having competitors with continuing rights as unitholders. The Court should apply the forfeiture provisions as written and reverse the judgment, or at the very least hold that VPM's interpretation is reasonable and cannot be summarily rejected on a Rule 12 motion for judgment on the pleadings.

II. THERE IS NO BASIS TO EXCUSE WEST FROM HIS AGREEMENT

LKQ should also foreclose any argument that West can escape enforcement of the forfeiture provisions based on equitable considerations. The former employee in *LKQ* was "a plant manager earning a modest salary and benefits" who would be required to return "eight years of LKO stock sale proceeds." *See LKQ*, 2024 WL 5152746, at *4; *LKQ Corp. v. Rutledge*, 96 F.4th 977, 986 (7th Cir. 2024) .(noting that "LKQ seeks to clawback eight years of stock award proceeds" worth "at least $600,000" from "a middle manager making a modest salary (about $109,000)," with no limit on how far back the recapture could extend).)

By contrast, West was a "Senior Vice President, Practice Management" who resigned after less than two years at VPM. (*See* Compl. ¶¶ 11, 19, 21.) West also signed Investment Representation Statements warranting that he had sufficient time and information to make a knowledgeable decision regarding the acquisition of his Class B Units and could bear the risk of a complete investment loss.[4] Unlike the

[4] *See* Compl. Ex. 3, Award Agreements Ex. B (acknowledging that West "is aware of the Company's business affairs and financial condition and has acquired sufficient information about the Company to reach an informed and knowledgeable decision to acquire the Securities," that he "is able to bear the economic risk of an investment in the Securities including the risk of a complete loss of his or her investment," that "***the Company has given him or her, at a reasonable time prior to the date of purchase or grant, an opportunity to review the terms and conditions of the Class B Units Award Agreement, the Plan and the Operating Agreement***" and "an opportunity to obtain any additional information that the Company possesses or can acquire without unreasonable effort or expense deemed necessary by him or her to verify the accuracy of the information provided") (emphasis added).

former employee in *LKQ*, VPM is not asking to "claw back" any out of pocket cash "proceeds" from stock sales (let alone proceeds nearly six times greater than the employee's annual salary for transactions spanning eight years). *See LKQ*, 2024 WL 5152746, at *4. VPM instead merely seeks the right to cancel West's units if he joins a competitor. If anything, VPM has a far stronger interest in preventing former-employees-turned-competitors from continuing to hold Class B Units than LKQ had in recovering proceeds from stock sales to third parties. (*See supra* at 4-5.)

The Court should also be particularly reluctant to nullify a forfeiture provision in the LLC context given the Legislature's express command to maximize freedom of contract and enforceability of LLC agreements. (*See supra* at 3; *see also Soleimani v. Hakkak*, 2024 WL 1593923, at *10 (Del. Ch. Apr. 12, 2024) (enforcing plain language requirements in LLC agreement and citing LLC Act's "freedom of contract" clause; noting that while the losing party "may find this outcome unpalatable," parties "'have a right to enter into good and bad contracts, the law enforces both.'" (internal citations omitted).) Allowing West to escape his bargain would undermine, rather than maximize, the freedom and enforceability of contracts.

Accordingly, if a corporation can enforce an agreement to recapture eight years of proceeds from open market stock sales that dwarf the employee's "modest" $109,000 annual salary by a factor of six without reasonableness review, there is no basis for applying a reasonableness review to a senior executive who was employed

at VPM for less than two years and who is not being asked to return cash to the company. *See Andaloro v. PFPC Worldwide, Inc.*, 2005 WL 2045640, at *3 (Del. Ch. Aug. 19, 2005) ("As sophisticated executives, these minor stockholders knew how to protect themselves by contract"). And there is certainly no basis for making a reasonableness determination at the pleading stage when West has not even alleged—let alone proven—that he is "unsophisticated."

CONCLUSION

LKQ further supports enforcement of West's bargain and should foreclose any reading of the Award Agreements and Plan other than the normal construction principles applicable to all contracts. The Court should reverse the judgment.

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