

Recent Case Addresses LLC Managers' Authority to Delegate

The Delaware Court of Chancery recently issued an important opinion addressing the ability of managers of a limited liability company to delegate to non-managers. *Obeid v. Hogan*, CA. No. 11900-VCL (Del. Ch. Jun. 10, 2016). In *Obeid*, the plaintiff was a member and director of a board-managed LLC (the "Corporate LLC") and a member and manager of a manager-managed LLC (the "Manager LLC" and, together with the Corporate LLC, the "LLCs"). The plaintiff sued the other directors and managers of the LLCs directly and derivatively on behalf of the LLCs. The other directors and managers then voted to create a special litigation committee (the "SLC") for each LLC, which SLC was comprised of an individual who was neither a director of the Corporate LLC nor a manager of the Manager LLC, to determine whether to pursue the derivative actions on behalf of the LLCs. The plaintiff brought this action challenging whether a non-director or non-manager could serve on the SLC.

With respect to the Corporate LLC, the court applied corporate law doctrine because the limited liability company agreement of the Corporate LLC (the "Corporate LLC Agreement") contained governance provisions paralleling those of a corporation. Citing *Zapata v. Maldonado*, 430 A.2d 779 (Del. 1981), the court noted that only a committee made up of directors can assert control over a derivative action under corporate principles; thus, delegating that power to a non-director of the Corporate LLC would be an improper delegation of the board's authority. The defendants argued that managers of a limited liability company can fully delegate their powers to a non-manager pursuant to Section 18-407 of the Delaware Limited Liability Company Act (the "LLC Act"). Section 18-407 provides that a manager has the power and authority to delegate the manager's rights and powers to manage and control the business and affairs of the LLC. In response, the court noted that Section 18-407 validates the delegation of ordinary course business tasks—not "every theoretically possible delegation." Additionally, the court noted that Section 18-407, as a "general default provision addressing the delegation of managerial authority," does not trump Sections 18-1001 and 18-1003, which are the LLC Act's specific provisions regarding derivative actions. Sections 18-1001 and 18-1003 refer only to managers or members as having the authority to make the decision on behalf of a limited liability company whether to pursue a derivative action. Moreover, the court stated that Section 18-407 could not validate the Corporate LLC board's attempted delegation to the non-director serving on the SLC because the Corporate LLC Agreement "provided otherwise" by incorporating a corporate-style governance structure, which evidenced the drafters' intent to have corporate principles, including *Zapata*, apply.

With respect to the Manager LLC, the court stated in dicta that the governance structure of the Manager LLC contained sufficient corporate features to merit application of the Corporate LLC analysis, but it reached its decision on other grounds. The court noted that the language of the limited liability company agreement of the Manager LLC (the "Manager LLC Agreement") drew a distinction between ordinary course actions that could be handled by non-managers and "more significant matters" that could be handled only by managers. The Manager LLC Agreement provided that managers could delegate to another manager or managers the authority to take actions in furtherance of the Manager LLC's purposes and to bind the Company. The court read this language as evidencing the intent of the drafters of the Manager LLC Agreement to "provide otherwise" under Section 18-407 and "limit the ability of managers to delegate their core governance functions" solely to other managers. The court held that, because the member of the SLC was not a manager of the Manager LLC, the managers could not delegate their authority to determine whether to pursue the derivative action on behalf of the Manager LLC to this non-manager.

This opinion illustrates the importance of careful drafting in alternative entity governance documents. Particularly, drafters should consider (1) whether they intend to incorporate corporate governance principles into their limited liability company or limited partnership agreements and (2) the intended scope of delegation to non-managers, non-members and non-general partners.

To discuss the Delaware law implications of the Obeid case, [attached here](#), please contact a member of the Morris Nichols Delaware Alternative Entities Group referenced below.

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