

Contractual Ambiguities Favor the Non-Moving Party at Motion To Dismiss Stage

Thursday, May 16, 2019

In *Coyne v. Fusion Healthworks, LLC* Civil Action No. 2018-0011-MTZ (Del. Ch. April 30, 2019), the Delaware Court of Chancery denied a motion to dismiss for failure to state a claim (the “Motion”) filed by Fusion Healthworks, LLC (the “LLC”), James Sheehan with his personal medical practice, and Andrew Lietzke, with his personal medical practice (collectively, the “Defendants”). In denying the Motion, the court reiterated the standing principal that, when presented with a contractual ambiguity, dismissal at the motion to dismiss stage is only appropriate “if the defendants’ interpretation [of the ambiguity] is the *only* reasonable construction as a matter of law.” *Coyne* highlights the critical nature of competent drafting of LLC Agreements.

Kathleen Coyne (the “Plaintiff”) is the widow of a deceased member of the LLC, Christopher Coyne. Christopher and two other men owned and operated the LLC pursuant to a Limited Liability Company Agreement (the “LLC Agreement”). The members executed a “Buy-Sell Agreement” (the “Buy-Sell”) in April 2012 which mandated that the LLC purchase life insurance policies, the proceeds of which would be used to buy a member’s limited liability company interest from his estate upon an untimely death. The Buy-Sell identified each member’s spouse as the beneficiary to the applicable policy, but also identified the LLC as the owner and primary beneficiary of all life insurance policies, while requiring that the LLC file, collect, and pay all of the proceeds on any claim to a deceased member’s estate in return for that deceased member’s limited liability company interest in the LLC. Crucially for the circumstances here, the Buy-Sell would terminate upon dissolution of the LLC.

Lietzke filed for bankruptcy in 2013, which was an involuntary withdrawal under the LLC Agreement and should have removed him from the LLC’s voting membership. Lietzke neither disclosed his interest in the LLC during his bankruptcy proceedings, nor told Christopher of such bankruptcy. Lietzke’s secrecy allowed him to continue to operate, fraudulently, as a full member of the LLC. Lietzke and Sheehan “stopped providing information to Christopher... created a compet[ing company] and funneled the LLC business to themselves, at Christopher’s expense, and stole LLC assets, both outright and through improper payments of personal expenses.” Christopher contested the actions of his former partners in court, but his mental state deteriorated as legal bills mounted before he took his own life in early 2016.

The insurance company paid the LLC the proceeds of the life insurance policy for Christopher’s death, but the LLC refused to pay the proceeds to Christopher’s estate pursuant to the Buy-Sell. As a threshold matter, Defendants contended Plaintiff lacked standing to enforce the Buy-Sell. The court disagreed, finding Plaintiff had standing as a third-party beneficiary to the Buy-Sell because (1) the parties intended for her to benefit, even if indirectly, from the Buy-Sell; (2) the Buy-Sell was a promise to perform between the LLC and Christopher, and Plaintiff was an intended beneficiary of the promised performance; and (3) the intention to benefit Plaintiff was a material part of entry by the members into the Buy-Sell.

Defendants claimed that the following LLC Agreement provision caused the LLC to dissolve when Lietzke filed for bankruptcy, regardless of whether or not the other members of the LLC were informed, because there was no affirmative vote by the remaining members to continue the business of the LLC:

The Company shall be dissolved... upon the occurrence of an Involuntary Withdrawal of a Member,



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unless the remaining Members, within ninety days after the occurrence of the Involuntary Withdrawal, by majority vote, elect to continue the business of the Company.

However, Plaintiff read the provision differently, contending that the provision *required* a vote be taken *before* the LLC could dissolve. For the Defendants to prevail on the Motion, their interpretation of the provision must be the *only* reasonable construction of the provision as a matter of law. In construing the provision, the court interprets both the plain language of the provision *and* the reasonableness of the result relative to the rest of the LLC Agreement.

Here, the Court of Chancery found both interpretations of the provision to be reasonable. While the interpretation put forth by the Defendants tracks the plain language of the provision most closely, it produces an absurd result by putting the fate of the LLC in hands of a withdrawn member, especially when that member does not disclose the conditions which would cause an Involuntary Withdrawal. In comparison, Plaintiff's interpretation would keep managerial power in the hands of the remaining members, consistent with the rest of the LLC Agreement, which specifically deprives a Withdrawn Member of any control over the company by shifting interest to the successor and limiting that interest to economic rights only.

Finally, Defendants argued that the LLC was effectively dissolved in 2015, but this position ignored the fact that Lietzke was a Withdrawn Member and the actions taken based on his voting power were not effective. For these reasons, the court ordered the Motion denied and appointed a receiver for the LLC pursuant to a separate claim by Plaintiff under Section 18-805 of the Delaware Limited Liability Company Act.

[Coyne v. Fusion Healthworks, LLC, Civil Action No. 2018-0011-MTZ](#)

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