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Recent Case Clarifies Personal Jurisdiction Law In Delaware

By **Francis Pileggi** (May 10, 2018, 1:07 PM EDT)

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The Delaware Court of Chancery recently ruled that the simple act of forming a Delaware entity is not sufficient alone to impose personal jurisdiction over a nonresident involved in that formation. There are circumstances, however, in which the formation of a Delaware entity, coupled with other facts, could form the basis for imposing personal jurisdiction over nonresidents involved in the formation.

The case of Baier v. Upper New York Investment Co. LLC, involved litigation lasting many years, in several countries, among siblings fighting over inheritance from their parents. The estate involved assets in multiple foreign countries and some of those assets were transferred into Delaware entities. The siblings involved in this litigation lived in different continents and there were many issues involved, but this short article focuses on the issues of personal jurisdiction.

The siblings, who were suing each other over the division of the estate assets of their parents, alleged that one of the siblings should be subject to jurisdiction of the Delaware courts because of his formation of a Delaware entity into which some of the disputed assets were transferred.

Delaware applies a two-step personal jurisdiction analysis. First, the court determines whether there is a statutory basis for personal jurisdiction. Second, the court decides whether the imposition of personal jurisdiction over a nonresident is consistent with the due process clause of the 14th Amendment of the United States Constitution. Jurisdiction was asserted based on the Delaware Long-Arm Statute at Section 3104 of Title 10 of the Delaware Code and the consent statute applicable to managers of limited liability companies at Section 18-109 of Title 6 of the Delaware Code. The court rejected both arguments.

Delaware's Long-Arm Statute

Section 3104(c)(1) is referred to as a "single act" long-arm statute. It requires a nexus to the claims against a nonresident defendant and the defendant's single act of transacting business in Delaware. In other words, the act or acts of transacting business in Delaware must be "an integral component of the total transaction to which the plaintiff's cause of action relates."

The allegations in this case were that the transaction of business in Delaware was the formation of an LLC. But that formation alone was insufficient for the court to exercise jurisdiction, because the act of formation was not "an integral component of the total transaction to which the plaintiff's cause of action relates."

The court found that the formation of the Delaware entity could not have been integral to the allegations of a fraudulent scheme because the scheme was allegedly completed prior to the formation of the Delaware entity. That is, the Delaware entities did not exist at the conclusion of the alleged fraud, much less having been integral to the fraud. In addition, the LLC had no offices, no employees and conducted no business. Therefore there was no activity in Delaware by the LLC after its formation and thus, the long-arm statute was not a basis for jurisdiction.

The court also explained that prior to any jurisdictional discovery, only a prima facie showing is needed to establish personal jurisdiction. After jurisdictional discovery is completed, however, one must allege specific facts to support personal jurisdiction.

LLC Manager Consent Statute

The court also rejected the argument that there was personal jurisdiction over the manager of the LLC. Section 18-109 of the Delaware LLC Act is an implied consent statute that allows the imposition of personal jurisdiction in Delaware over a nonresident manager of an LLC in civil actions brought in the state of Delaware "involving or relating to the business of the limited liability company" or involving a "violation by the manager of a duty to the limited liability company." The court instructed that there are three requirements that must be satisfied in order to justify the exercise of personal jurisdiction over a nonresident as a manager pursuant to Section 18-109: First, the claims at issue must focus on the manager's rights, duties and obligations; second, the resolution of the matter must be inextricably bound up in Delaware law; and third, Delaware must have a strong interest in providing a forum for the resolution of the type of dispute at issue.

These requirements were not satisfied in this case because the court determined that any fraud that may have occurred took place prior to the formation of the Delaware entity. Therefore, the allegations of fraud could not have arisen out of the rights, duties and obligations of the manager of the LLC. Next, the court determined that the resolution of the matter was not inextricably linked to Delaware law because the allegations of fraud occurred in the country of Ecuador. Lastly, principles of comity dictated that Delaware not offer a forum to resolve a dispute over foreign assets in foreign estates governed by foreign law, especially when foreign courts, as in this matter, had already made substantive rulings relating to the controversy.

The court reasoned that having found no statutory basis under either Section 3104(c)(1) or Section 18-109 to assert personal jurisdiction, it was not necessary to address the due process inquiry that would otherwise be included in an analysis of personal jurisdiction.

The court found that even if it were to have personal jurisdiction, the claims were barred by the equitable defense of laches. Laches applied because the claimant was on inquiry notice of the claim as early as August 2011. The court determined that the claimant unreasonably delayed in bringing the claim and did not exercise the degree of diligence that fairness and justice required under the circumstances, because he did not pursue his claims until five years after he was first put on inquiry notice of the alleged wrongdoing. During that time, he was aware of other siblings who were litigating related claims. The court found that the delay could not be justified under any reasonably conceivable set of facts. Moreover, the filing of a claim in a court of equity after the expiration of the analogous statute of limitations is presumptively an unreasonable delay for purposes of laches. The applicable statute of limitations for the claims in this matter was three years.

In sum, although there are circumstances in which the formation of a Delaware entity, when the formation is an integral part of a larger fraudulent scheme, could be part of the basis for the imposition of personal jurisdiction by Delaware courts, the facts of this case did not satisfy the applicable prerequisites.

The holding in this case is consistent with prior Delaware decisions on personal jurisdiction. The prior Delaware cases that have imposed jurisdiction in Delaware over someone who formed a Delaware entity did so based on the act of formation being part of a larger scheme to defraud or being one step in a long series of events leading up to, and forming the basis of, some type of misfeasance.

A takeaway for practitioners from this decision is that the formation of a Delaware entity must serve an integral role in a more layered scheme to commit, for example, a breach of fiduciary duty, before Delaware courts will consider imposing personal jurisdiction over the parties involved. In addition, however, even if the Delaware long-arm statute is satisfied, the Delaware courts will also determine if the due process clause of the U.S. Constitution is satisfied before imposing personal jurisdiction.

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