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Personal Jurisdiction Defenses May Protect Parent Entities

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Real estate investment trusts and other parent-level real estate companies typically form subsidiary partnerships and limited liability companies to own or manage real estate assets. Those subsidiaries are often formed in states other than the state in which the parent entity is formed. Parent entities, however, may wish to avoid litigation in states in which their subsidiaries are formed — for instance, doing so might limit liability, reputational harm or exposure to strategically disadvantageous jurisdictions.

A recent Delaware decision provides important guidance on whether such parent entities can assert a personal jurisdiction defense to avoid lawsuits filed in foreign states in which their subsidiaries are formed. The decision confirms that parent entities may be able to assert a successful personal jurisdiction defense in such lawsuits, but only if they take certain steps to minimize their contacts with the foreign state. Under the law governing personal jurisdiction, a company cannot be sued in a foreign state unless a statutory basis for jurisdiction exists, and the company has sufficient contacts with the foreign state.

In the case of Weil et al v. VEREIT Operating Partnership LP, and VEREIT Inc., C.A. No. 2017-0613 JTL (Del. Ch. Dec. 13, 2017), VEREIT was sued in the Delaware Court of Chancery for breach of certain indemnity agreements. VEREIT was a Maryland REIT and the sole owner and general partner of a Delaware limited partnership. Delaware law provides that a general partner like VEREIT automatically consents to personal jurisdiction in Delaware courts for disputes “involving or relating to the business of the limited partnership.” Further, VEREIT had multiple contacts with Delaware. VEREIT’s Delaware partnership held nearly all of VEREIT’s real estate assets, any recovery under the indemnity agreements in dispute would have come from VEREIT’s Delaware partnership, and a related lawsuit (which prompted the indemnity claims against VEREIT) involved allegations relating to VEREIT’s management of the Delaware partnership.

Despite those facts, the Delaware court determined that it lacked personal jurisdiction over VEREIT. Among other things, the court distinguished between VEREIT’s own activity in Delaware and that of VEREIT’s Delaware partnership. On that basis, the court found that the indemnity claims alleged against VEREIT did not relate to VEREIT's Delaware activity — that is, VEREIT's formation, management and maintenance of the subsidiary partnership. The court also found that the indemnity agreements in dispute were not related to Delaware. Rather, the agreements were governed by Maryland law, and VEREIT's Delaware partnership was not a party to the agreements.

Based on Weil, REITs and other parent entities may be able to avoid lawsuits in Delaware and other foreign states in which a subsidiary is based by asserting a personal jurisdiction defense, particularly in a lawsuit where:

- the claims against the parent entity are based on an agreement that does not involve significant activity by the parent entity in the foreign state;
- the agreement at issue is governed by the law of the parent entity's home state (as opposed to the foreign state); and
- the subsidiary formed in the foreign state is not a party to the agreement at issue.

Securing dismissal of lawsuits filed in foreign states through a personal jurisdiction defense may provide a parent entity important advantages. A plaintiff may respond to dismissal by filing a new lawsuit in the parent entity's home state. But a plaintiff may choose not to do so for expense reasons, or a plaintiff may choose to go after a subsidiary alone, in which case a parent entity may avoid a lawsuit altogether. In that event, a parent entity may be better protected from liability and reputational damage associated with a lawsuit. Even if a plaintiff chooses to file a new lawsuit in the parent entity's home state, such a change in venue eliminates the parent entity's exposure to foreign forums that may be inconvenient or strategically unfavorable.

REITs and other parent-level real estate firms may wish to take proactive measures to increase their ability to assert a personal jurisdiction defense in lawsuits filed in foreign states in which a subsidiary is based. The following steps may help:

- Form parent and subsidiary entities in separate jurisdictions (REITs are commonly formed in Maryland, while subsidiary entities are commonly formed in Delaware or in a state in which real estate assets are owned);
- When drafting agreements to which the parent entity is a party, make the governing law different from the state(s) in which subsidiaries are based;
- Avoid making the parent entity a party to any agreements to which a subsidiary is also a party; and
- Avoid business activity by the parent entity in states in which subsidiaries are formed or conduct business.

A more detailed discussion of the facts and the court's decision in Weil follows.

In October 2014, VEREIT announced that its audit committee had identified errors in its financial statements. Afterwards, several lawsuits were filed in Delaware against VEREIT, the directors and officers of VEREIT and VEREIT's Delaware partnership. The directors and officers then sought indemnification from VEREIT for expenses they incurred related to that litigation. When VEREIT disputed the indemnification request, the directors and officers sued VEREIT for breach of contract in the Delaware Court of Chancery in a separate lawsuit captioned Weil, et al v. VEREIT Operating Partnership LP, and VEREIT Inc.

VEREIT responded by moving to dismiss the indemnity suit for lack of personal jurisdiction. Under Delaware law, a Delaware court has personal jurisdiction over a defendant only if there is a basis for personal jurisdiction in Delaware's statutes. In addition, under the U.S. Constitution, personal jurisdiction exists only if a defendant has sufficient minimum contacts with the state in which the court sits.

The Delaware court first evaluated whether Delaware's Limited Partnership Act provided a statutory basis for personal jurisdiction. The act provides that anyone serving as a general partner of a Delaware partnership automatically consents to jurisdiction of Delaware courts for disputes "involving or relating to the business of the limited partnership." The court assumed, without deciding, that the indemnity claims related to the business of VEREIT's Delaware partnership, and thus the act could provide a statutory basis for personal jurisdiction. Nonetheless, as discussed next, the court determined that VEREIT had insufficient minimum contacts with Delaware to establish personal jurisdiction under constitutional principles of due process.

In deciding whether VEREIT had minimum contacts with Delaware, the court noted that the underlying litigation involved allegations about VEREIT's management of the Delaware partnership, the partnership held nearly all of VEREIT's assets and any payment under the indemnity agreements would ultimately come from the partnership.

Despite those facts, the court held that VEREIT's contacts with Delaware were insufficient to establish personal jurisdiction. The court explained that the claims for breach of the indemnity agreements were "straightforward breach of contract claims under agreements governed by Maryland law," that only VEREIT (and not the Delaware partnership) was a party to the agreements, and that the indemnity agreements themselves were not connected to Delaware. The court further held: "The partnership is not a necessary or proper party to the claims against VEREIT, and the claims have only a limited and indirect relationship to the business of the partnership." And the court noted that ruling on the indemnity agreements would "not require a significant inquiry into the business of the partnership," even though it would require examining the pleadings and other filings in the underlying litigation.

The court also evaluated whether Delaware's Long-Arm Statute provided a statutory basis for personal jurisdiction. In relevant part, Delaware's Long-Arm Statute provides for personal jurisdiction over an entity that "[t]ransacts any business or performs any character of work or service in the State." Here, the plaintiffs argued that VEREIT met that standard by organizing the Delaware partnership under Delaware law, holding "virtually all of its assets through the partnership," and owning property in Delaware through the partnership.

The court, however, held that Delaware's Long-Arm Statute did not confer personal jurisdiction over VEREIT. In particular, the court held that the claims for breach of the indemnity agreements did not have a "nexus" to VEREIT's "Delaware-focused act of forming the partnership" or VEREIT's act of "owning property in Delaware" through the partnership. The court also noted that the indemnity claims "d[id] not relate to the partnership's internal governance." Similarly, the court noted that the partnership's Delaware properties "do not have anything to do with the [indemnity] claims."

In sum, Weil demonstrates that REITS and other parent entity real estate firms may be able to avoid lawsuits brought in Delaware or other states in which their subsidiaries are formed by asserting a personal jurisdiction defense. As described above, parent entities may wish to take certain steps to increase the likelihood that they will be successful in asserting such a personal jurisdiction defense.

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