

**Miscellaneous Recent (Non-Delaware)  
Partnership and LLC Cases**

**2019 Spring Meeting  
ABA Business Law Section  
LLCs, Partnerships and Unincorporated Entities Committee  
Vancouver, BC  
March 29, 2019**

**Elizabeth S. Miller  
M. Stephen and Alyce A. Beard Professor  
of Business and Transactional Law  
Baylor University School of Law**

## Table of Contents

Veil Piercing. ....	1
Personal Liability of Member for LLC Debts Under Operating Agreement. ....	3
Entity Nature of Partnership or LLC. ....	5
Capital Contributions. ....	8
Fiduciary Duties. ....	13
Indemnification. ....	16
Information Rights. ....	20
Interpretation of Operating Agreement or Partnership Agreement. ....	22
Assignment of Interest; Restrictions on Transfer. ....	39
Withdrawal of Member. ....	45
Derivative Suits. ....	49
Charging Order. ....	53

## Miscellaneous Recent (Non-Delaware) Partnership and LLC Cases

Elizabeth S. Miller

### Veil Piercing

*Sky Cable, LLC v. DIRECTV, Inc.*, 886 F.3d 375 (4th Cir. 2018).

After a judgment against an LLC and its sole member went unsatisfied, the district court entered an amended judgment that reverse pierced the veil of three other LLCs owned by the individual and made them co-judgment debtors with the individual. On issues of first impression, the court of appeals affirmed the district court's decision and held that Delaware law permits the remedy of reverse veil piercing when the LLC is the alter ego of its member.

In 2000, Randy Coley, through his subsequently-defunct East Coast Cablevision, LLC ("ECC"), contracted with DIRECTV, Incorporated ("DIRECTV") to provide its programming to 168 rooms at a Virginia resort. In 2011, an investigation by DIRECTV revealed a fraudulent scheme pursuant to which ECC and Coley received payment for cable services provided by DIRECTV to over 2,500 units at the resort while continuing to pay DIRECTV only for those services provided to the 168 units. DIRECTV eventually obtained a judgment for \$2.4 million against Coley and ECC for violations of federal communications law based on the unauthorized receipt and distribution of DIRECTV's programming.

Coley dissolved ECC after the district court entered its judgment, and DIRECTV was unable to collect any payment from Coley, who had few personal assets. Discovery in the post-judgment phase of the case revealed that several LLCs owned and managed by Coley held title to or managed Coley's assets. DIRECTV filed a motion in the district court to reverse pierce three LLCs owned and managed by Coley in order to obtain access to the assets of these LLCs. These three companies were not parties to the case and had not been served with process. In 2016, the district court entered an amended judgment rendering the three LLCs co-judgment debtors with Coley and held that: (1) under Delaware law, the three LLCs were alter egos of Coley; (2) Delaware would recognize reverse veil piercing under such circumstances; and (3) DIRECTV's failure to serve process on the three LLCs did not prevent the court from exercising jurisdiction over them. Coley and one of the three LLCs appealed, arguing that Delaware law does not permit reverse piercing of a corporate veil even when the corporation is the alter ego of the judgment debtor, and that Delaware's LLC charging order statute provides the exclusive remedy for a judgment creditor seeking access to the financial interest of an LLC's member.

The court of appeals reviewed *de novo* whether Delaware law would permit reverse piercing of an LLC. The court first discussed corporate and LLC veil piercing in general and distinguished the various types of veil piercing. The court explained that traditional veil piercing permits a court to hold an owner liable for a judgment against the entity, whereas reverse veil piercing imposes liability on the entity for a judgment against an owner. The court further explained that an additional classification of reverse piercing concerns the origin of a request to the court to disregard the entity's form: "insider" reverse piercing applies when the entity's controlling owner makes such a request, whereas "outsider" reverse piercing (relevant here) applies when an outsider/third party (often a creditor) makes the request.

Because the law of the state in which an entity is "incorporated" generally governs the question of whether a court may pierce an entity's veil, and the parties did not dispute that Delaware law applied to the reverse piercing claim, the court relied on Delaware case law to analyze whether Delaware permits reverse veil piercing. The court discussed Delaware's recognition of traditional

veil piercing as an equitable remedy in exceptional circumstances and noted that the purpose of reverse piercing is to hold a company liable for a member's actions to prevent fraud or injustice. The court stated that reverse piercing is particularly appropriate when an LLC has a single member because there are no other members whose interests are affected. According to the court, "because Delaware courts apply the alter ego theory only in exceptional circumstances, recognition of reverse veil piercing for the limited purpose of preventing fraudulent conduct would not threaten the general viability of the corporate form in Delaware." The court noted Delaware's "powerful interest. . .in preventing entities that it charters from being used as vehicles for fraud," and the court discerned that Delaware courts have "signaled some willingness to apply a theory of reverse veil piercing." Thus, the court concluded that "Delaware would recognize outsider reverse veil piercing of an LLC's veil when the LLC is the alter ego of its sole member."

The court next analyzed Coley's contention that Delaware's LLC charging order statute precluded reverse piercing of his LLC based on the following "exclusivity" provision of the statute:

The entry of a charging order is the exclusive remedy by which a judgment creditor of a member or a member's assignee may satisfy a judgment out of the judgment debtor's limited liability company interest and attachment, garnishment, foreclosure or other legal or equitable remedies are not available to the judgment creditor, whether the limited liability company has 1 member or more than 1 member.

6 Del. Code § 18-703(d).

Although Delaware courts have not interpreted this provision, the court found it to be clear that piercing the veil of an alter ego was not the type of remedy the statute was intended to prohibit. The court applied the statutory construction rule of "*ejusdem generis*" and concluded that the general reference to "other legal or equitable remedies" applied only to types of remedies that are similar to those specifically listed, i.e., "attachment, garnishment, [and] foreclosure." Reverse veil piercing of an LLC when the LLC is the alter ego of its sole member permits the court to treat the LLC as "identical" to its member and effectively eliminates the legal status of the LLC in narrow circumstances involving fraud or injustice. Therefore, the court considered reverse piercing to be unlike the common-law seizure remedies listed in the exclusivity provision of the charging statute. Additionally, the court determined that Coley's interpretation of the charging order statute would impermissibly limit Delaware's ability to prevent the entities that it charters from being used as vehicles for fraud.

The court then analyzed Coley's contention that the district court erred in reverse piercing the veil of Coley's LLC because the district court failed to make a finding of fraudulent purpose. The appellate court stated that in order to prevail under an alter ego theory, a plaintiff is not required to show "actual fraud but must show a mingling of the operations of the entity and its owner plus an 'overall element of injustice or unfairness.'" The court stated that an inference may be drawn that entities are one and the same if they fail to follow corporate formalities when doing business with one another. In a footnote, the court noted that "LLCs must observe fewer *internal* formalities than corporations, but the principle that they should follow ordinary formalities and norms when doing business with other entities is the same." The court described evidence of commingling of funds, lack of proper accounting records, unexplained transfers of funds, and payments by one LLC of another LLC's or Coley's expenses or obligations. The court also concluded that an "overall element of injustice or unfairness" was present because DIRECTV had not yet received any payment on its

judgment obtained more than four years ago. Based on this evidence, the appellate court concluded that the district court's finding of alter ego was not clearly erroneous.

Next the court rejected Coley's contention that the district court erred in holding that Coley's participation in the post-judgment proceedings permitted the district court to exercise jurisdiction over his LLC despite the fact that the LLC was not served with process. The appellate court reasoned that when reverse veil piercing a single-member LLC, the individual is already before the district court, and there is no concern that the alter-ego LLC must receive independent notice of a legal action. Thus, the court held that an LLC that is the alter ego of its sole member is properly before the court when the court has jurisdiction over the member.

Finally, the court rejected Coley's argument that the district court erred in applying the doctrine of equitable estoppel in the post-judgment proceedings with respect to the contention that Mrs. Coley was also a member of his LLC. During the pre-judgment proceedings, Mrs. Coley represented that she was not an owner of any of Coley's business entities and was not a member of the LLC. Coley also testified that he was the sole member of the LLC and produced an operating agreement that indicated he was the sole member. DIRECTV relied on these representations in dismissing Mrs. Coley. After the judgment was entered, the Coleys sought to establish that Mrs. Coley was a member (in order to oppose reverse piercing the LLC on the basis that it would prejudice Mrs. Coley as an innocent owner), and the court concluded that "[t]he Coleys' shifting positions reflected an attempt to assert whatever position would advance their quest to avoid liability and place their personal assets beyond the reach of DIRECTV." Thus, the court held that the district court did not abuse its discretion in estopping the assertion of Mrs. Coley's interest in the LLC in the post-judgment proceedings.

### **Personal Liability of Member for LLC Debts Under Operating Agreement**

*VanWinkle v. Walker*, No. 2016-CA-000097-MR, 2018 WL 4043388 (Ky. Ct. App. 2018).

The court of appeals held that the operating agreement of a Kentucky LLC unambiguously required a member to pay an amount equal to one-third of the LLC's liabilities based on a provision of the operating agreement that divided the "profits and liabilities" of the LLC equally between the three members.

In 2004, Troy VanWinkle, Lyle Walker, and Carl David Crawford formed TLC Developers, LLC ("TLC"), and executed an operating agreement. TLC's business purpose was to develop and build residential structures in Madison County, Kentucky. Several years later, TLC experienced severe cash-flow problems and was unable to pay its business expenses. Because Walker and Crawford believed that the operating agreement required the members to pay equally for these expenses if TLC could not, they contributed personal funds to the company's account. VanWinkle claimed that he was not required to pay expenses of TLC, although he did pay one-third of TLC's property taxes on multiple occasions.

In 2013, Walker and Crawford filed a complaint seeking a declaration of rights as to the members' dispute over the agreement to equally pay TLC's liabilities. After a bench trial, the circuit court determined that the operating agreement unambiguously stated that the three members agreed to split company liabilities in thirds and ordered VanWinkle to pay \$87,000 as his one-third share of TLC's liabilities.

On appeal, VanWinkle argued that the circuit court erred because: (1) the operating agreement contained an express provision protecting the members from personal liability; and (2) holding the members personally liable for TLC's liabilities would be inconsistent with the intent of the Kentucky Limited Liability Company Act (the "Kentucky LLC Act").

The court's analysis of VanWinkle's first argument focused on two separate provisions in the TLC operating agreement. One of these provisions, titled "Immunity from Personal Liability" (the "Immunity provision"), stated:

As provided in [Kentucky LLC Act] 275.150, no member, employee or agent of the Company will be personally liable by reason of such status under a judgment, decree, or order of a court or agency, or tribunal of any type, or in any other manner, in this or any other state, or on any other basis, for a debt, obligation, or liability of the Company, whether arising in contract, tort, or otherwise. The status of a person as a Member, employee or agent of the Company shall not subject the person to personal liability for the acts or omissions, including any negligence, wrongful act, or actionable misconduct, of any other Member employee or agent of the company.

The other provision, titled "Division of Profits and Liabilities" (the "Division provision"), stated:

The profits and liabilities of the Company shall be divided as follows: Carl David Crawford = thirty-three and one-third (33 1/3%), Lyle A. Walker = thirty-three and one-third (33 1/3%) percent and Troy Van Winkle [sic] thirty-three and one-third (33 1/3%).

VanWinkle contended that the Immunity provision acted "as a shield against *any* personal liability arising from" TLC's liabilities, despite the existence of the Division provision. The court disagreed, first noting that the Immunity provision was "almost identical" to Section 275.150(1) of the Kentucky LLC Act, which does, in general, limit personal liability of members of an LLC. Because of this direct reference to a specific statute, the court concluded that the members "clearly" intended to mimic Section 275.150. Second, the court noted that VanWinkle appeared to ignore Section 275.150(2), which states that the members may alter the general rule of nonliability by agreeing to be personally obligated for the liabilities of the LLC in a written operating agreement. The court concluded that Section 275.150(2) was articulated in the TLC operating agreement under the Division provision. Third, the court referenced case law for the requirement that "[a]ny such assumption of personal liability ... must be stated clearly in *unequivocal language* which leaves no room for doubt about the parties' intent[.]" citing *Racing Inv. Fund 2000 v. Clay Ward Agency*, 320 S.W.3d 654, 659 (Ky. 2010) (emphasis added). The court concluded that the language of the second provision met this "unequivocal language" standard because the Division provision unambiguously mandated that TLC's liabilities be divided evenly between the three members, and the provision appeared on the same page of the agreement that VanWinkle signed. The court also pointed out that, because VanWinkle previously paid his share of the company's property taxes on at least two occasions, it appeared that "he understood this provision at one point in time." As a result, the court rejected VanWinkle's first argument.

The court then turned to VanWinkle's argument that he could not be personally liable for TLC's liabilities because "the hallmark of an LLC—and [the Kentucky LLC Act, by extension]—is to limit the liability of LLC members." The court agreed that members are not, as a general rule, liable for the liabilities of the LLC under the Kentucky LLC Act. However, the court pointed out that Section 275.003 of the Kentucky LLC Act provides that it is the policy of the statute "to give maximum effect to the principles of freedom of contract and the enforceability of operating agreements" to allow business partners the freedom to contract and structure an LLC to fit the needs

of its members. The court noted that holding the members personally liable for TLC's liabilities may seem contrary to the point of establishing an LLC, but this result adhered to the legislative intent of allowing members the freedom to contract and establish an LLC that fits their needs. Here, the three members each agreed to the equal division of TLC's liabilities, and the circuit court thus did not err in ordering VanWinkle to pay his agreed-upon share of the company's liabilities.

### **Entity Nature of Partnership or LLC**

*Moss v. Princip*, 913 F.3d 508 (5th Cir. 2019).

The court affirmed the trial court's dismissal of a nondiverse partnership in a suit brought by two partners alleging claims against the other two partners for fraud, breach of fiduciary duty, breach of partnership agreement, conversion, and money had and received. The court concluded that the partnership was dispensable because all partners were party to the suit and the partnership's interests in the suit were adequately represented by the partners. Further, any risk of duplicative litigation brought by the partnership itself could be prevented by injunctive relief. The court applied the same reasoning to an LLC formed by one of the plaintiffs and one of the defendants.

The plaintiffs, separately, formed partnerships with defendant Marko Princip, whereby each plaintiff received 30% ownership in the partnership. The plaintiffs filed suit against Princip and another partner, Martin, alleging that the parties had created a partnership and that the defendants were liable for common-law fraud, breach of fiduciary duty, breach of the partnership agreement, conversion, and money had and received. The defendants removed the case to federal court from a Texas state court on the basis of diversity jurisdiction. A jury determined that a partnership existed among the parties, and the defendants moved to dismiss the claim for lack of subject-matter jurisdiction just before the entry of final judgment. The defendants argued that there was incomplete diversity due to the presence of the partnership. The plaintiffs moved to dismiss the partnership as a dispensable nondiverse party. The trial court granted the plaintiffs' motion, restoring complete diversity, and the defendants appealed.

The court of appeals first recognized that for purposes of diversity jurisdiction, a partnership is a citizen of every state in which one of its partners is a citizen. Ordinarily, diversity jurisdiction must exist at the time of removal. However, courts may dismiss nondiverse parties under Rule 21, "even after judgment has been rendered." Under Rule 19, a court can dismiss a required party who would destroy diversity, if the court determines the party is dispensable. When making this determination regarding "whether, in equity and good conscience, the action should proceed among the existing parties," the court will consider four factors. These four factors include: (1) the extent to which a judgment rendered in the person's absence might prejudice that person or the existing parties; (2) the extent to which any prejudice could be lessened or avoided by protective provisions in the judgment, shaping the relief, or other measures; (3) whether a judgment rendered in the person's absence would be adequate; and (4) whether the plaintiff would have an adequate remedy if the action were dismissed for nonjoinder. As the court noted, this analysis requires a case-by-case approach.

The court noted two previous decisions of the Fifth Circuit Court of Appeals in which the court found the partnership indispensable when the claims were derivative of the partnership's interests. However, recognizing Rule 19 as a flexible and pragmatic approach, the court distinguished the two prior decisions on the basis that they involved "threatened prejudice to the partnership if the case proceeded in its absence." Further, in neither of the two cases were all constituent partners of the partnership parties to the suit. The court looked instead to decisions by sister courts in which the courts found a partnership's interest was adequately represented when all

partners, or all general partners, were parties to the suit. While the court suggested the trial court could consider the tactical advantage of the partnership's presence, no such advantages were present in this case, where the partnership's role was purely passive throughout the litigation. The court acknowledged that a partnership is legally treated as a separate entity, but the court stated that “[a] partnership's interests as an entity consist of an aggregation of those interests of each of the individual partners that are relevant to the purpose of the partnership.”

The court next addressed the defendants' assertion that the partnership was required to be joined as a “real party in interest” under Rule 17(a). The court pointed out that the Texas partnership statute provides for liability of a partner to a partnership or its partners for breach of the partnership agreement or violation of duties. The court commented in a footnote that some Texas courts have construed the statute to restrict partners' ability to sue for actions that have diminished the value of the partnership, but the court pointed out that these cases only address limited partnerships, and the court cited other cases indicating that the logic of these limited partnership cases is not universally accepted. The court stated that it could not conclude that the partnership was required to be joined as a plaintiff here because any interest of the partnership was fully represented and vindicated and there was no need to preserve partnership assets for all partners' benefit. The court reiterated that the partnership was a proper party but was not indispensable since its interest was fully represented by the presence of all partners. The court further explained that “the fact that an absent person could bring the action as a real party in interest does not of itself make that person a necessary or indispensable party.” Although Rule 17 insures that a judgment will generally have proper effect as *res judicata* and protect a defendant from the risk of subsequent litigation, the court stated that any risk of duplicative litigation could be alleviated through properly tailored protective provisions in the judgment (such as injunctive relief prohibiting the plaintiffs from suing the defendants on behalf of the partnership on claims the partnership could have raised in the suit and ordering the plaintiffs to cause the partnership to release the claims as a condition of judgment).

The defendants also raised essentially the same challenges based on the presence of an LLC formed by one of the plaintiffs and one of the defendants. The court stated that the defendants did not argue that the LLC should be treated differently from the partnership, and the court stated that its analysis extended to the LLC, which was also dismissed by the district court.

In sum, the court concluded that the partnership and LLC were not indispensable parties, and the court remanded the case in order for the district court to consider appropriate injunctive relief to guard against any risk of duplicative litigation.

***Reynolds v. Lyman***, 903 F.3d 693 (7th Cir. 2018).

The court of appeals held that the managing member of several LLCs could not bring a legal malpractice suit on his own behalf because there was no attorney-client relationship between the managing member and the law firm or lawyer. The court also held that the law firm and lawyer did not owe a third-party duty of care to the managing member based on the representation of the LLCs, and the managing member was not an intended third-party beneficiary of the law firm's retainer agreement with the LLCs.

Brian Reynolds co-owned and managed several LLCs, which were represented by a law firm and one of its lawyers (collectively, “the firm”). In his capacity as managing member, Reynolds communicated with and was advised by the firm. Reynolds brought a legal malpractice suit against the firm, alleging that the firm gave negligent advice to these LLCs and this advice led him to violate federal disclosure laws when he drafted the companies' financial statements. The district court granted summary judgment to the firm, explaining that Reynolds could not bring a legal malpractice



suit on his own behalf because he did not have a personal attorney-client relationship with the firm. Reynolds appealed.

The court of appeals began its analysis by listing the elements under Illinois law of a legal malpractice claim, the first element of which is an attorney-client relationship. The court further noted that the Illinois Supreme Court has described the attorney-client relationship as “a voluntary, contractual relationship that requires the consent of both the attorney and client.” Reynolds admitted that he never asked the firm to represent him individually and that the firm never said anything to suggest it was representing Reynolds, but Reynolds argued that the firm owed him a third-party duty of care from its legal representation of the LLCs because his personal interests and those of the companies were “so closely bound ... as to be functionally indistinguishable.” The court characterized his theory as facially plausible but “foreclosed by decades of Illinois law.”

The court pointed to Illinois cases consistently holding that neither shared interests nor shared liability give rise to liability to a third party. Instead, the claimant must have been a direct and intended beneficiary of the legal representation in order for an Illinois attorney to be liable to the claimant as a third party. The mere fact that Reynolds was at risk of personal liability did not transform the incidental benefits of the firm’s representation of the LLCs into direct and intended benefits for Reynolds. Under Illinois law, the lawyer for a business entity generally owes a duty of care to the entity itself and not to the individual owners, officers, or directors. The court acknowledged that an Illinois attorney does owe a duty of care to a third party when “hired for the primary purpose of benefitting that third party.” The court noted, however, that Illinois courts have emphasized that the “primary purpose of a retainer agreement between a business entity and a lawyer is to benefit the business entity, not to benefit that entity’s owners or officers, however closely aligned their interests might be.”

Even if the court had the power to change Illinois law or carve out exceptions, the court stated that the current rule “makes good sense.” According to the court, adopting the approach advocated by Reynolds would undermine the integrity of the attorney-client relationship by forcing attorneys to assume competing duties of care to non-clients. Likewise, Reynolds’ approach would “chip away” at the legal distinction between business entities and individuals and introduce a “bizarre” double standard whereby business owners or officers could hide behind the limited-liability business structure to defend a lawsuit, yet cast that structure aside as plaintiffs when seeking to recover for injuries sustained by the business. Thus, the court concluded that the firm did not owe Reynolds a third-party duty of care arising out of its representation of the LLCs and was not liable to Reynolds as a third party for legal malpractice.

In the alternative, Reynolds argued that he had a valid breach-of-contract claim against the firm because he was an intended third-party beneficiary of the firm’s retainer agreement with the LLCs. The court characterized this claim as duplicative of Reynolds’ legal malpractice claim and thus applied similar reasoning. The record did not suggest that the firm undertook its representation of the LLCs for the “direct and manifest purpose” of benefitting Reynolds, as is required for third-party beneficiary status in Illinois. The court held that Reynolds was not a third-party beneficiary of the firm’s retainer agreement with the LLCs and, as a result, he did not have a breach-of-contract claim against the law firm.

Finally, Reynolds attempted to avoid summary judgment by arguing that the district judge lacked the power to grant summary judgment because the *Erie* doctrine allocates duties between a judge and jury and federal procedural law required a jury—not a judge—to determine whether a duty was owed. The court was not persuaded for two reasons. First, the court noted that the issue of whether a duty exists is a question of law to be decided by a judge. The court further noted, “at the risk of stating the obvious,” that whether Illinois law imposes a duty of care on someone is a

question about the scope of Illinois law, and federal procedure generally requires judges to answer such “scope” questions. Second, the court reasoned that even if the existence of a duty was a jury question under federal law, Illinois substantive law would govern and that law is clear that an attorney for a business entity generally owes a duty of care to the entity itself. The court concluded that no reasonable jury could have found in Reynolds’ favor based on the facts he alleged and summary judgment against him thus was proper.

### **Capital Contributions**

*Nicolazzi v. Bone*, 564 S.W.3d 364 (Mo. Ct. App. 2018).

In a dispute regarding a member’s breach of an LLC operating agreement and alleged withdrawal from the company, the court of appeals concluded that the trial court did not err in finding that the member breached the operating agreement by failing to make his required initial capital contribution, but the breach did not equate to his withdrawal under the operating agreement or the Missouri Limited Liability Company Act.

Peter Nicolazzi and Laura Bone formed Young in Spirit Adult Day Care, LLC (the “LLC”), an adult daycare business, in 2005. Immediately following its formation, Nicolazzi and Bone were the LLC’s only workers and, under the operating agreement they signed in 2005, the only members. Nicolazzi was responsible for performing service-related tasks for the LLC’s customers and Bone primarily performed managerial and nursing duties. When business expanded, Bone’s duties grew while Nicolazzi’s tasks were handled by employees that the company hired. As time went on, the parties’ business relationship deteriorated. In 2011, Nicolazzi did not seek Bone’s permission before he approached a competitor about buying his interest in the LLC. On April 30, 2011, Nicolazzi effectively stopped participating in the operation of the LLC, while Bone continued to operate the LLC. In June of 2011, Bone filed articles of incorporation for “Young in Spring Adult Day Center, Inc.” and, on the next day, notified Nicolazzi that the business would continue in this new entity and that she would be dissolving the LLC.

On June 30, 2011, Nicolazzi filed his petition against Bone and requested: (1) a declaratory judgment determining whether Bone was still a member and whether she had misappropriated LLC funds, and ordering Bone to reimburse Nicolazzi for distributions received in excess of her fifty percent share; (2) a complete accounting from Bone of the LLC and the new business entity; and (3) judgment for the losses, expenses, and damages that Bone owed to Nicolazzi for his interest in the LLC. Among her counterclaims, Bone asked the trial court to find that Nicolazzi was no longer a member of the LLC because he breached the operating agreement by failing to make his required capital contribution and by soliciting purchase of his membership interest by a third party without her consent. After a bench trial, the trial court entered judgment in favor of Bone and against Nicolazzi, finding that Nicolazzi breached the LLC’s operating agreement by failing to make the required capital contribution and by soliciting purchase of his membership interest without Bone’s consent, and that his actions constituted “events of withdrawal” under the Missouri Limited Liability Company Act (the “Missouri LLC Act”). The trial court concluded that Nicolazzi was no longer a member of the LLC, that Bone was the sole member and owner of the LLC, and that Nicolazzi had been paid all salary and distributions the LLC owed to him. After Nicolazzi’s motion for a new trial and amendment of the judgment was denied, he appealed.

Because Nicolazzi’s arguments on appeal depended upon the application of the LLC’s operating agreement and the Missouri LLC Act, the court cited a number of Missouri law propositions, including: (1) “[w]hile limited liability companies are creatures of statute, [the court] ‘interpret[s] an L.L.C.’s operating agreement according to the ordinary rules of contract law””; (2)

“[t]he primary rule of contract interpretation is to determine the intent of the parties and to give effect to that intent”; (3) “[i]n interpreting an operating agreement, [the court] applie[s] the plain and ordinary meaning of the words in the agreement and consider[s] the document as a whole”; and (4) “[w]here a contract’s terms are clear and unambiguous, [the court will] enforce the agreement as written and will not supply additional terms.” The court also cited the Missouri LLC Act for the requirement that member(s) adopt an operating agreement and the statutory definition of “member” as “any person that signs in person . . . or otherwise is a party to the operating agreement at the time the [LLC] is formed and is identified as a member in that operating agreement. . . .” The court reasoned that because Nicolazzi was named in the LLC’s operating agreement, he signed the operating agreement when the LLC was formed, and the operating agreement did not establish any further condition or prerequisites to membership, then he was a member from that point forward. The court of appeals further concluded that Nicolazzi and Bone were the only members of the LLC throughout the company’s existence.

The standard of review in this case required the court of appeals to affirm the trial court’s judgment unless there was no substantial evidence to support it, it was against the weight of the evidence, or it erroneously declared or applied the law. The court organized its discussion around two primary issues: first, whether Nicolazzi breached the LLC’s operating agreement; and second, whether Nicolazzi’s actions constituted withdrawal from the LLC, leaving Bone as the sole member.

The first issue that the court of appeals addressed was whether the trial court erred in finding that Nicolazzi breached the LLC’s operating agreement. Nicolazzi argued that the trial court’s conclusion that he breached the operating agreement by failing to make his initial capital contribution was against the weight of the evidence. The LLC’s operating agreement contained a provision requiring Nicolazzi and Bone to contribute capital in equal amounts, including “initial contributions” of \$50,000 each. However, no deadline was stated in the operating agreement and neither party testified that a due date had been agreed to otherwise. At trial, the parties presented “staggeringly” different amounts when providing evidence of Nicolazzi’s cash and non-cash capital contributions during the five years between the LLC’s formation and when he filed his petition: Bone and the LLC’s CPA testified that he had contributed \$31,065, while Nicolazzi and his retained expert witness (who was also a CPA) testified that he had contributed \$79,271. In its judgment, the trial court justified its determination that the testimony on Bone’s side was more credible and reliable by recognizing “inconsistencies and shortcomings” in Nicolazzi’s purported contributions and that his expert’s opinion was based on those facts. The trial court even noted that “[i]t was difficult at best, impossible at worst, to sort out [Nicolazzi’s] personal finances from company business.” Because the court’s deference to the trial court’s findings of facts in this case extended to credibility determinations of witnesses, the court of appeals held that the trial court’s conclusion that Nicolazzi breached the LLC’s operating agreement by failing to make his required initial capital contribution requirement was not against the weight of the evidence. The court of appeals noted that it was not necessary to analyze the meaning of the word “initial” in relation to the required capital contributions, despite the absence of a deadline in the operating agreement, because it was established at trial that both parties intended and understood the \$50,000 would be paid within six months of the execution of the LLC’s operating agreement. The court further noted that under any definition of “initial,” Nicolazzi’s failure to make the required initial capital contribution within a five-year time span undoubtedly constituted a breach of the operating agreement. Therefore, the court of appeals affirmed the trial court’s judgment in this regard.

After concluding that Nicolazzi’s mere attempt to sell his interest in the LLC without Bone’s consent did not breach the restriction on transfer contained in the operating agreement, the court of appeals addressed whether the trial court erred in finding that Nicolazzi’s actions constituted an

“event of withdrawal” under the Missouri LLC Act, leaving Bone as the LLC’s sole member. The court of appeals observed that the trial court relied on two provisions of the Missouri LLC Act when it concluded that Nicolazzi’s actions of failing to make his required initial capital contributions, attempting to sell his membership interest, and leaving the LLC in April of 2011 constituted “events of withdrawal.” The Missouri LLC Act permits a member to withdraw from a LLC as specified in writing in the operating agreement, at any time upon giving ninety-days’ prior written notice to the other members, or under certain conditions (e.g., assignment of a member’s entire interest in the LLC or expulsion as a member in accordance with the operating agreement). Because the LLC’s operating agreement was silent on what would constitute an event of withdrawal, Nicolazzi did not give any written notice to Bone, and the other statutory conditions were not present before Nicolazzi filed his petition, the court of appeals concluded that the trial court erroneously applied the two provisions of the Missouri LLC Act in finding that Nicolazzi’s actions constituted “events of withdrawal” from the LLC. The court pointed out that while it did affirm the trial court’s finding that Nicolazzi breached the operating agreement by failing to make his initial capital contribution, that breach did not equate to his withdrawal under the operating agreement or the Missouri LLC Act. As a result, the court of appeals reversed the trial court’s judgment in that regard.

The court of appeals went on to suggest that Nicolazzi’s actual filing of his petition may itself have constituted an “event of withdrawal” under the Missouri LLC Act, but this issue was not before the trial court, so the court of appeals remanded the case to the trial court to determine if Nicolazzi withdrew pursuant to the Missouri LLC Act, and if he did, to determine the “fair value” of his interest in the LLC at the time of withdrawal.

***Sohani v. Sunesara***, 546 S.W.3d 393 (Tex. App. 2018).

The court of appeals held that the trial court erred in entering a judgment that a member of three LLCs was entitled to one-third of the profits of each of the LLCs because the Texas Business Organizations Code provides that profits and losses are allocated to the members based on the agreed value of the members’ contributions as stated in the company’s records, and none of the LLCs had a record of the member’s alleged contribution. Although the member testified that he contributed cash to the LLCs, and the jury found that the member was entitled to a one-third profit distribution from each LLC, the court of appeals stated that allowing the member’s oral testimony to establish his entitlement to one-third of the profits of the LLCs in the absence of any written records of his contributions would be contrary to the plain language of the LLC statute.

Nizar Sunesara and Anis Virani started selling smoking accessories and devices in flea markets on the weekends in 2002, and the next year they established a brick-and-mortar retail shop called “Zig Zag Smoke Shop.” Sunesara created MNA Corporation to operate Zig Zag, and Virani and Sunesara offered Manisch Sohani (a supplier of Zig Zag) an ownership interest in the business. The three men each owned one third of MNA Corporation, and profits of Zig Zag were distributed in cash each month. Sunesara and Virani both took positions with Sohani’s company, and Sunesara transitioned out of the day-to-day business of Zig Zag while Virani continued to manage Zig Zag’s day-to-day operations as well as working for Sohani’s company. Zig Zag did well, and in 2012, Virani and Sunesara started a second retail location, which they called “Burn Smoke Shop” (“Burn I”). Sunesara testified that he contributed \$10,000 cash to the start up of Burn I. He stated that he gave the money to Virani and did not request any receipt or documentation of his contribution. SSV Corporation, which was incorporated by Sunesara in 2007, owned the assets of both Zig Zag and Burn I. Sunesara and Virani each owned 50% of SSV Corporation, but records showed that Sohani shared equally with Sunesara and Virani in profit distributions, and Sunesara testified that Sohani was considered a partner even though he was not a formal owner.

Toward the end of 2012, Sunesara, Virani, and Sohani agreed to buy an existing retail smoke shop, whose name they changed to “Burn Smoke Shop Two” (“Burn II”). Sunesara testified that he contributed \$10,000 cash to the start up of Burn II, again giving the money to Virani without obtaining any receipt or documentation of his contribution. Before the purchase of Burn II was finalized, Sohani and Virani asked Sunesara to file paperwork with the Texas Secretary of State to form three LLCs to run the three smoke shops. Each certificate of formation, which was signed by Sunesara but not the other two men, listed Sohani, Virani, and Sunesara as governing persons. Signature cards and depository resolutions for the bank accounts for the three LLCs listed all three men as members and were signed by all three men. Virani and Sohani claimed that Sunesara handled the paperwork for forming the LLCs and opening the bank accounts, and Virani and Sohani claimed that they should have been listed as the only two members of the LLCs. The franchise tax public information report for 2013 listed all three men as members of the LLCs, but the franchise tax report for 2014 as well as federal income tax returns for 2013 and 2014 only listed Virani and Sohani as members or owners of the LLCs.

Sohani and Virani testified that Sunesara did not contribute anything to the three shops. They also testified that they never received any profit distributions from the LLCs because the profits went to Sohani’s company to pay back inventory Sohani contributed and to pay other vendors and creditors of the LLCs.

After federal law enforcement officers began targeting sellers of synthetic marijuana and raiding retailers, wholesalers, and distributors in the smoke shop industry, Sunesara became concerned because Sohani’s company and the three retail shops sold synthetic marijuana. Sunesara wanted Sohani’s company and the shops to stop selling the product. Sohani’s company was raided in 2013, and Sunesara took a leave of absence from the company and did not return. After the raid, Sohani and Virani realized that they lacked important documentation for the LLCs, such as operating agreements, and (after conducting internet research) the two men drafted and signed form operating agreements listing them as members and stating that they each made 50% of contributions and owned 50% of profits and assets. Sunesara’s name did not appear in any of the three agreements, and he was not involved in the drafting of the agreements. Sunesara testified that he received monthly profit distributions for the first five months of 2013 and inquired regularly “what the situation was with profit distributions” after the raid but was given excuses why there were no distributions until October of 2013, when the parties ceased communicating. The parties disagreed over whether Sunesara had a share of the business, and Sohani and Virani were unable to open new bank accounts or obtain loans for the LLCs without Sunesara’s authorization and signature. In 2015, Virani and Sohani sued Sunesara asserting various causes of action, including a claim for a declaratory judgment that Sunesara was not a member of the LLCs. Sunesara counterclaimed for a declaration that he was a member of the LLCs, was entitled to one-third of the profits of the LLCs, and was entitled to examine the LLCs’ books and records.

The jury answered “yes” to three questions inquiring whether Sunesara was a member entitled to a one-third profit distribution of each of the LLCs at the time they were formed. No definitions or instructions accompanied these questions. The jury also found that Sohani and Virani were estopped to deny Sunesara was a member of the LLCs and that Sunesara did not commit fraud against Virani and Sohani. After the verdict, Virani and Sohani moved to dismiss the action for lack of subject-matter jurisdiction based on documentation that they argued demonstrated the combined total of one-third profit distributions from the three LLCs exceeded \$200,000, the upper limit of the county court’s jurisdictional limits. Sohani and Virani also argued that Sunesara presented only his self-serving testimony that he was a member and had made contributions to the LLCs but presented no evidence of an oral or written operating agreement entitling him to membership and one-third of

the profits of the LLCs. Virani and Sohani relied on Tex. Bus. Orgs. Code § 101.201, which provides that profits and losses of an LLC shall be allocated on the basis of the agreed value of the contributions made by each member, as stated in the company's records. The trial court entered judgment in favor of Sunesara declaring that he was a member of the LLCs and entitled to one-third of the profits from the LLCs.

The court of appeals analyzed the contention of Sohani and Virani that the trial court's judgment, which declared that Sunesara was a member of each of the LLCs and was entitled to one-third of the profits from each of the LLCs, conflicted with Section 101.201 of the Business Organizations Code, which states that an LLC's allocation of profits and losses are to be made "on the basis of the agreed value of the contributions made by each member, as stated in the company's records." Sohani and Virani argued that there was no written record reflecting Sunesara's contributions to the LLCs or demonstrating that he was entitled to one-third of the profits. The court reviewed the definitions of a "member," "membership interest," "governing documents," "company agreement," and "contribution," and pointed out that the Business Organizations Code does not require a person to make a contribution in order to be admitted as a member or acquire a membership interest. The court also pointed out that the statutory provisions addressing allocation of profits and losses and the sharing of distributions provide that such matters are based on the agreed value of each member's contributions as stated in the company's records required to be kept under the statute. Tex. Bus. Orgs. Code §§ 101.201, 101.203. Section 3.151 of the Business Organizations Code contains general recordkeeping requirements for filing entities, and Section 101.501 has specific requirements for LLCs that include maintaining a record of "the amount of a cash contribution and a description and statement of the agreed value of any other contribution made or agreed to be made by each member." Tex. Bus. Orgs. Code § 101.501(a)(7).

The court's analysis of Sohani's and Virani's contention focused on the "plain meaning" of Sections 101.201 and 101.501 of the Business Organizations Code. At trial, Sunesara testified that he made contributions to the LLCs in the form of \$10,000 cash contributions and "deferred profits" to the startup of Burn I and the acquisition of Burn II. Sunesara did not, however, offer any documentary evidence reflecting those contributions. The record contained no writing setting out the specific contributions made by any of the three members or stating that Sunesara was entitled to one-third of the profits from the LLCs. The company agreements for each of the LLCs were admitted into evidence, but they listed only Sohani and Virani as members and stated, under each of their names, "Made 50% of contributions, Owns 50% of profits and assets." The court construed Section 101.501 of the Business Organizations Code to require an LLC to include a statement of the amount of cash contributions made by each member and a statement of the agreed value of any other contribution made by each member in the written records of the company and construed Section 101.201 to provide that these records establish the allocation of a member's share of the profits and losses of the company. Because Sunesara did not introduce any records of the LLCs reflecting the contributions that he made to the LLCs, the court concluded that he presented no evidence that he is entitled to one-third of the profits of the LLCs under Section 101.201.

Sunesara argued that his testimony that he made contributions to the LLCs sufficed to demonstrate his entitlement to one-third of the profits of the LLCs, but the court stated that the plain language of Section 101.201 requires profits and losses to be allocated on the basis of the agreed value of the contributions made by each member, as stated in the company's records required under Section 101.501, and the plain language of Section 101.501 requires an LLC to maintain a written record of the amount of a cash contribution and a description and statement of the agreed value of any other contribution made or agreed to be made by each member.

Sunesara pointed to the 2008 tax return of MNA Corporation (which stated that Sunesara, Virani, and Sohani were each allocated one-third of the profits for that corporation) and the records of SSV Corporation (which stated that Sunesara and Virani each owned fifty percent of that corporation) and argued that, when the LLCs were created and took over operation of the smoke shops, these records became a part of the records for the LLCs and satisfied the writing requirement of Section 101.201. But the court stated that the corporations and LLCs were all separate and distinct entities, and Sunesara cited no law supporting the proposition that the records from the earlier-formed entities became records of the new LLCs when they began operating the smoke shops. The court stated that the documentary evidence reflecting that Sunesara had a one-third ownership interest in MNA Corporation and a one-half interest in SSV Corporation established only that he was entitled to distributions from MNA Corporation and SSV Corporation, not that he made contributions to the LLCs or that he was entitled to one-third of the profits from the LLCs. Thus, the court held that the trial court erred to the extent that it ruled that Sunesara was entitled to one-third of the profits from each of the LLCs. “Because Sunesara was not assigned a share of profits in the company agreements and presented no evidence that he was entitled to a one-third share of profits in the LLCs, he was not entitled to a share in profits as a matter of law.”

### **Fiduciary Duties**

***800 South Wells Commercial LLC v. Cadden***, 103 N.E.3d 875 (Ill. App. Ct. 2018).

An Illinois LLC sued a former officer for breach of fiduciary duties in connection with the acquisition and subsequent transfer of certain leasehold interests in a commercial development. The appellate court held that a non-member vice president did not owe any fiduciary duties to the manager-managed LLC. The court rejected the LLC’s argument that the officer owed fiduciary duties, either by virtue of his title as vice president or by allegedly exercising managerial control over the LLC. In the alternative, the court went on to conclude that there was no evidence to demonstrate a breach even if the officer did owe fiduciary duties to the LLC.

The operating agreement of a two-member, manager-managed LLC contained a provision stating that its purpose was to obtain a leasehold interest in the commercial space and parking garage (the “Assets”) of a complex consisting of five components: commercial space, a parking garage, an apartment complex, a surface parking lot, and a marina. The operating agreement named Nicholas Gouletas (“Gouletas”) as the LLC’s managing member and permitted him, as manager, to appoint officers to assist in the LLC’s operations.

Gouletas and the other member of the LLC jointly issued a certificate of managing member authority (the “Certificate”) on behalf of the LLC. The Certificate appointed John Cadden (“Cadden”) as the LLC’s vice president and authorized the LLC to acquire the leasehold interest in the Assets. The lease initially included rights to the marina, but it had been amended to remove the marina, and the Certificate ordered and directed Cadden to approve the amendment and proceed with the lease on behalf of the LLC. At closing, the LLC received a leasehold interest in only the Assets, which were encumbered by first and second mortgages. A few years later, the LLC was in default on both mortgages.

WRT-Marc RC, LLC (“WRT”) sought to acquire the Assets by purchasing the first mortgage and then initiating a foreclosure. At this time, a separate Gouletas-owned entity known as River City Commercial (“RCC”), was the fee simple owner and lessor of the Assets. In order to obtain a fee simple interest in the Assets, WRT sought consent of the LLC and RCC to a foreclosure. Cadden was still vice president of the LLC and had also become vice president of RCC. During negotiations with WRT, an agreement arose that neither the LLC nor RCC would contest the foreclosure of the

Assets, provided that WRT granted an option to acquire the parking garage from WRT at WRT's cost. WRT prepared a document evidencing the option agreement ("Option #1"), but it went unsigned and undated by either the LLC or WRT. Eventually, WRT and Cadden (in his capacity as RCC's vice president) executed a written and signed option agreement ("Option #2") granting RCC the option to acquire the parking garage. WRT obtained a foreclosure judgment and purchased the Assets at a foreclosure sale. Subsequent to the foreclosure, the holder of the second mortgage took control of the LLC's voting rights, removed Gouletas as the LLC's manager, and ended Cadden's role as the LLC's vice president. The LLC filed a complaint against Cadden, alleging breach of fiduciary duties he owed to the LLC as its vice president. The LLC contended that Cadden owed it fiduciary duties for two reasons: by virtue of Cadden's title as vice president and because Cadden exercised managerial control over the LLC. The trial court entered summary judgment in favor of Cadden on the basis that he owed no fiduciary duties to the LLC or alternatively that the evidence did not establish a breach of any fiduciary duty.

The first issue addressed by the court of appeals was whether the trial court erred in concluding that Cadden did not owe the LLC any fiduciary duties. The LLC contended that Cadden owed it fiduciary duties for two reasons: by virtue of Cadden's title as vice president and because Cadden exercised managerial control over the LLC. With respect to the first reason, the LLC argued that neither the Illinois LLC Act nor any relevant agreement was intended to supplant the common-law doctrine that an officer of a corporation owes fiduciary duties to the corporation. The court's analysis of this first argument focused primarily on relevant provisions of the Illinois LLC Act, the operating agreement, and the Certificate. Because the Illinois LLC Act directly addresses who does and does not owe fiduciary duties in the context of a manager-managed limited liability company, the court concluded that the common-law considerations and analogies to corporations cited by the LLC were not relevant. The court reviewed the statutory provisions addressing fiduciary duties owed to a manager-managed limited liability company and pointed out that the statute provides that such duties reside in the manager alone and not in a non-manager member solely by reason of being a member. 805 ILCS 180/15-1(c), 180/15-3(g)(1). Furthermore, the court pointed out that Section 15-5 of the Illinois LLC Act allows a limited liability company to enter into an operating agreement to regulate the affairs and business of the company and the relations among the members, managers, and company. 805 ILCS 180/15-5(a). In this case, the LLC's operating agreement, which was adopted in accordance with the Illinois LLC Act, specified that Gouletas was the sole manager and empowered him to appoint officers. Section 5.9 of the LLC's operating agreement detailed the responsibilities of these officers and provided:

The Managing Member shall elect officers ("Officers") to carry out the policies and objectives of the Managing Member. Subject to the policies and objectives prescribed by the Managing Member, the Officers shall establish operating procedures for, and administer and direct, the day to day operations of the Company. The powers of the Officers may be broadened or limited from time to time in the discretion of the Managing Member and each Officer shall, at a minimum, be empowered to carry out (and shall carry out) any activity expressly authorized in a written resolution of the Managing Member. ... Each Officer shall serve until removed by the Managing Member. The Managing Member may remove any Officer at any time for any reason. ... No Officer shall receive any compensation for such Officer's services to the Company.



Although the operating agreement stated that Cadden, as an officer, was charged with the “day to day operations” of the LLC, the court stated that Cadden had “no free rein” in any respect to control the LLC and was authorized to do only what the manager ordered. The Certificate appointed Cadden as vice president “in accordance with the provisions of Section 5.9 of the Operating Agreement” and ordered him to take specific action with respect to the leasehold interest. Because all power and duties resided in the manager, the court characterized the title of vice president in this context as irrelevant. Based on the Illinois LLC Act, the LLC’s operating agreement, and the Certificate, the court concluded that Cadden owed no fiduciary duties to the LLC.

Next, the court addressed the LLC’s argument that Cadden owed it fiduciary duties because he exercised managerial control over the company. The appellate court’s analysis continued despite noting that the LLC was procedurally prohibited from making this argument on appeal because it was not pled in the company’s complaint. In support of this second argument, the LLC relied on Section 15–3(g)(3) of the Illinois LLC Act, which states that, in a manager-managed limited liability company, fiduciary duties may be imposed on a person other than a manager, but only if that person “is a member who exercises some or all of the authority of a manager . . . .” 805 ILCS 180/15-3(g)(3). According to the LLC, Cadden “[r]an most of [Gouletas’s] companies” and therefore exercised sufficient managerial control to impose fiduciary duties under subsection (g)(3). The court acknowledged that Section 15–3(g)(3) is an exception to the general rule that only a manager owes fiduciary duties to a manager-managed limited liability company. Subsection (g)(3) contains a two-prong requirement in order to impose fiduciary duties on a person other than a manager of a manager-managed LLC: (1) the person is a member, and (2) that member exercises the same control and authority as the manager. 805 ILCS 180/15-3(g)(3). Because the record made clear that Cadden was not a member of the LLC, the court concluded that subsection (g)(3) was inapplicable. Still, assuming “for whatever unfathomable notion” that Cadden was a member, the court set forth additional support for its conclusion that Cadden did not exercise the requisite managerial control and authority under the statute: (1) Cadden was an officer without control of any facet of the LLC; (2) pursuant to the Illinois LLC Act, the LLC’s operating agreement, and the Certificate, Cadden had no power to act without the direction of the manager; and (3) the LLC was not dependent on Cadden to run the company because this duty fell solely to the manager, who governed the business, as well as the contents and duration of Cadden’s employment as officer. The court thus concluded that Cadden did not exercise managerial control over the LLC sufficient to impose fiduciary duties on him.

The second issue that the court of appeals addressed was whether the trial court erred in concluding that Cadden, assuming he did owe fiduciary duties to the LLC, did not breach those duties. The LLC contended that Cadden breached his fiduciary duties in two respects: by purposely diverting the parking garage option away from the LLC to a separate entity and “underhandedly” trading out the marina from the lease for no compensation. The court reviewed relevant Illinois case law and pointed out that a fiduciary is obligated to first disclose potential opportunities to the company and is prohibited from taking advantage of business opportunities that belong to the company. The court also pointed out that Illinois case law defines such opportunities as those in which the company has the capacity to engage and are reasonably incident to the company’s present or future business prospects. The court’s analysis of this contention focused on applying the definition of “business opportunities” to the parking garage option and marina (separately and independently). With respect to the parking garage option, the court noted that the LLC’s operating agreement stated that it “shall engage in no other business [other than a leasehold interest in the Assets]” until both the first and second mortgages were fully repaid. The LLC’s involvement with WRT and the consent foreclosure concerned only the first mortgage. Following the consent

foreclosure, however, the LLC remained liable to and in default on the second mortgage. The court determined that, at that point in time and according to its own operating agreement, the LLC could not engage in any business, including obtaining the parking garage option. As a result, the court then determined that the parking garage option was not incident to the LLC's business prospects because Option #1 was never a firm agreement. The court concluded that the parking garage option was not an opportunity in which the LLC could engage, and the parking garage option was not an opportunity reasonably incident to the LLC's business prospects. Thus, the parking garage option was not a business opportunity that belonged to the LLC, and Cadden could not have breached a fiduciary duty with respect to the parking garage option.

The court applied similar reasoning to the LLC's claim that Cadden breached his fiduciary duties to the company by underhandedly trading out the marina from the deal for no compensation. The court noted that according to the LLC's operating agreement, the company was specifically formed to acquire a leasehold interest in the Assets (the commercial space and parking garage). Therefore, the court concluded that the LLC was never intended to obtain an interest in the complex's three remaining components: the marina, the apartment complex, or the surface parking lot. As a result, the court found that the marina was not a business opportunity for the LLC. Furthermore, the record indicated that the initial lease included rights to the marina, the lease was then amended by the LLC's manager and members to remove the marina from the deal, and then (via the Certificate) Cadden was specifically ordered and directed to proceed with the amended lease for the Assets only and not the marina. The court stated that it failed to see how Cadden could breach a fiduciary duty with respect to a marina the LLC was never intended to possess.

The court further noted that, even if the parking garage option or the marina were business opportunities for the LLC, there was no evidence in the record to show that Cadden failed to disclose them to the company or derived personal gain from his alleged diversion from the LLC. In fact, the court noted that the evidence supported disclosure (the LLC's manager and all members attested that they knew Cadden was negotiating on behalf of it and RCC) and the absence of personal gain (Cadden testified that he never obtained any personal benefit).

## **Indemnification**

***Tangas v. Int'l House of Pancakes, LLC***, 298 F. Supp. 3d 1116 (N.D. Ohio 2018).

A former employee sued a restaurant-chain LLC and its parent corporation seeking indemnification for expenses incurred in defending against federal charges. The district court held that the former employee was not entitled to indemnification under the governing documents of either entity and the business judgment rule protected the LLC's decision to deny indemnification on the grounds that the former employee engaged in fraud and willful misconduct.

Autumn Lee Tangas began working for International House of Pancakes, LLC ("IHOP") in 1991 and became a "franchise bureau consultant" (FBC) in 2003. As an FBC, Tangas acted as a liaison to franchisees who operated restaurants in her multi-state territory, helped franchisees boost sales, and ensured that they adhered to IHOP operating standards. In September 2011, the FBI raided the home of a franchisee whose operations Tangas oversaw. After the raid, IHOP opened its own investigation to determine if the company itself might be a target of the FBI investigation or a potential victim of wrongdoing. In 2012, DineEquity's in-house counsel communicated to Tangas's lawyer that Tangas was obligated to cooperate with the internal investigation under the IHOP code of conduct and a refusal to do so would result in termination. After Tangas's lawyer responded that Tangas would not answer any questions, IHOP fired Tangas for violating the IHOP code of conduct and refusing to participate in the interview. A federal grand jury subsequently indicted Elkafrawi,

Tangas, and others. The indictment, which charged Tangas with money laundering, conspiring to harbor illegal aliens, and mail fraud, essentially alleged that Tangas used her position as an FBC to hide Elkafrawi's criminal activities from IHOP. The criminal case against Tangas proceeded for more than two years until the U.S. Attorney's Office dismissed the charges without prejudice in 2014. At that time, Tangas had incurred more than \$130,000 in legal fees. In 2015, Tangas demanded that IHOP pay these legal fees. After the FBI provided part of its investigative file to IHOP, the LLC denied her request in light of "the allegations in the indictment and supported by the evidence in the government interviews."

The first issue that the district court addressed was whether Tangas had a right to indemnification under DineEquity's corporate bylaws, which provided that the corporation must indemnify a person who is or may be a party to any suit "by reason of the fact that [s]he is or was a director or officer of the Corporation, or is or was serving at the request of the Corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust, employee benefit plan or other enterprise[.]" Therefore, in order to qualify for indemnification, Tangas was required to show that she was a director of DineEquity, that she was an officer of DineEquity, or that she served at the request of DineEquity as an employee of another corporation (i.e., that DineEquity requested Tangas to serve as an FBC for IHOP). The court held that Tangas did not have a right to indemnification under the DineEquity bylaws because she was neither a director nor an officer of the parent corporation, she did not serve IHOP at the request of DineEquity, and she was employed by the subsidiary LLC and not its parent corporation.

Tangas next argued that Delaware corporate law required DineEquity to indemnify her because she was successful in defending the criminal case. The court noted that, at one time, Delaware did require corporations to indemnify any director, officer, employee, or agent who was successful on the merits or otherwise in defense of any action. Under current law, however, the mandatory obligation to indemnify applies only to officers and directors. 8 Del. C. § 145(c). The court held that this mandatory indemnification provision did not apply to Tangas because she "was not an officer of any company, let alone DineEquity..."

Next the district court addressed whether Tangas had a right to indemnification under IHOP's LLC agreement. Both sides relied on the language of IHOP's LLC agreement, which provided that:

the Company shall indemnify and hold harmless each Covered Person from and against any and all losses, claims, demands, liabilities, expenses, judgments, fines, settlements and other amounts arising from any and all claims, demands, actions, suits or proceedings, civil criminal administrative or investigative ("Claims"), in which the Covered Person may be involved, or threatened to be involved as a party or otherwise, by reason of its management of the affairs of the Company or which relates to or arises out of the Company or its property, business or affairs. A Covered Person shall not be entitled to indemnification under this Section 8.2 with respect to (i) any Claim with respect to which such Covered Person has engaged in fraud, willful misconduct, bad faith or gross negligence[.]

The LLC agreement defined "Covered Persons" to include "the Member [i.e., DineEquity], any officers, directors, stockholders, partners, employees, affiliates, representatives, or agents of any of the Member," or "any officer, employee, representative, or agent of the Company [i.e., IHOP]." Because the parties agreed that Tangas was a "Covered Person" until she was fired in 2012, the court focused on determining if Tangas was entitled to indemnification of expenses incurred post-termination.

DineEquity and IHOP argued that Tangas’s indemnification rights did not continue post-termination because the Delaware LLC statute, unlike the corporate statute, does not provide a default rule that requires continuation of indemnification rights after a person ceases to be an employee, and such rights were not provided in IHOP’s LLC agreement. Tangas argued that IHOP impliedly agreed to cover expenses of former employees by failing to specify that the indemnification clause does not exclude former employees, but the court was not persuaded by Tangas’s interpretation of the indemnification clause because the interpretation was logically flawed (all categories of persons not defined as “Covered Persons” could claim indemnification) and unsupported by case law (absent explicit language inclusive of former employees, Delaware courts interpret “employee” as referring to current employees only). The court noted that the operating agreement had a provision limiting IHOP’s ability to amend the agreement to strip Covered Persons of their existing indemnification rights, but the language forbidding IHOP from retroactively stripping a Covered Person of existing indemnification rights did not prohibit IHOP from discontinuing indemnification once a person ceased to be a Covered Person. Tangas also argued that she had a vested right to indemnification that continued after her firing, but the court distinguished Delaware cases in which the courts determined that an indemnification right became vested and could not be terminated. The only right that could have vested in this case was Tangas’s right to be indemnified while she was a Covered Person involved or threatened to be involved in a proceeding. Because Delaware law did not prohibit IHOP from limiting its indemnification obligations in this manner and nothing in the LLC agreement required IHOP to indemnify a former employee whom it had fired, Tangas was not entitled to indemnification under the IHOP LLC agreement as a matter of law.

Finally, assuming *arguendo* that IHOP’s LLC agreement required it to indemnify Tangas, the district court addressed whether IHOP reasonably declined to indemnify Tangas on the basis that her conduct amounted to fraud or willful misconduct. IHOP and DineEquity argued that Delaware’s business judgment rule protected their decision not to indemnify Tangas, but Tangas argued that the business judgment rule was inapplicable because the LLC agreement entitled her to indemnification. The court concluded that the business judgment rule was applicable to the issue of whether Tangas engaged in fraud or willful misconduct. Because IHOP had the power to deny indemnification in those circumstances, the court stated that Tangas was asking the court to second guess the propriety of an action that IHOP had the authority to take and that Tangas must thus show IHOP’s decision to deny indemnification was not the product of reasoned, well-informed decision making. The court concluded that the undisputed evidence established that IHOP made a reasonable decision to deny indemnification after investigating the situation and concluding that Tangas engaged in fraud “with respect to” the criminal case against Tangas. Additionally, the court concluded that IHOP and DineEquity made a reasoned business judgment not to indemnify Tangas on the ground that her refusal to participate in the interview as required by IHOP’s code of conduct was willful misconduct “with respect to” the criminal case.

***Sandt v. Energy Maint. Servs. Group I, LLC***, 534 S.W.3d 626 (Tex. App. 2017).

The court of appeals affirmed the judgment of the trial court that a Delaware LLC owed indemnity to its officer and that a settlement agreement precluded further collection of the judgment against the officer.

Jim Sandt, a former officer and member of Energy Maintenance (a Delaware LLC), sued Energy Maintenance, Timothy Nesler (the company’s CEO), and other officers claiming that the defendants had committed fraud and breach of fiduciary duty by wrongfully diluting his ownership interest. While Sandt’s suit was pending, the Energy Maintenance board agreed in a company

resolution to indemnify Nesler for any liability arising out of or related to the Sandt litigation. The board resolution stated that the board agreed to indemnify Nesler after reviewing the Sandt litigation and discussing it with the company's officers and attorneys. The resolution also stated that the board had determined that Nesler acted in good faith and in a manner that he reasonably believed was in the company's best interest.

A jury found in favor of Sandt and against Energy Maintenance and Nesler. While an appeal was pending, the company's primary creditor took control and terminated Nesler from his position as CEO. The new board of directors then voted to revoke the prior indemnification as of the date it was purportedly granted. The rationale for the revocation was, in part, that Nesler had misrepresented to the board the facts related to the Sandt matter. After the company refused to provide indemnification, it filed suit against Nesler seeking a declaration that it did not owe him indemnity and claiming that the jury's findings of fraud and breach of fiduciary duty against him alleviated the company's indemnification obligation. Nesler counterclaimed for breach of contract.

The trial court ruled that Nesler was entitled to indemnification and that the company's failure to provide it was a breach of contract. Because a settlement agreement between the company and Sandt stated that Sandt could not recover any further, directly or indirectly, from the company, the trial court further declared that Sandt could not pursue Nesler for any amounts that the company had to indemnify. Both the company and Sandt appealed.

On appeal, the court noted that Energy Maintenance was a Delaware LLC; thus, Delaware law controlled the interpretation of the company's formation agreement. The court cited a number of Delaware law propositions, including (1) "[u]nder Delaware law, a limited liability company may indemnify any member, manager, or another 'against any and all claims and demands whatsoever,' subject to whatever standards or restrictions are included in its company agreement"; (2) "[f]or limited liability companies, Delaware law 'defers completely to the contracting parties to create and delimit rights and obligations with respect to indemnification'"; (3) "[w]hen interpreting the provisions of a limited liability company agreement, ordinary contract interpretation rules apply; the court's role is to effect the parties' intent based on the plain meaning of the agreement's terms"; and (4) "[a] court cannot rewrite or add omitted provisions in the guise of interpreting a contract."

The court noted that Article VIII of the Energy Maintenance company agreement contained provisions for indemnification and advancement of expenses. Although the provisions obligated Energy Maintenance to indemnify persons who acted in good faith, it vested the board with the authority to decide if they did act in good faith. The agreement expressly specified that an adverse judgment did not create a presumption of bad faith, and it stated a company policy of indemnifying corporate officers to the fullest extent legally possible. According to the court, "Energy Maintenance's company agreement does not, in express and affirmative terms, make members and directors ineligible for indemnification previously granted simply because a jury finds that they did not act in good faith, and we cannot rewrite its company agreement to say something it does not." In addition, the court concluded that unless Energy Maintenance had a contractual right to reconsider its decision to indemnify Nesler, it could not rescind its earlier determination. Because "[n]either its company agreement nor the board's 2007 indemnity resolution reserved a right to revisit Nesler's right to indemnity," the court concluded that the company "could not rescind its agreement to indemnify him."

Despite the company agreement provisions that vested the board with the authority to determine whether the conditions for authorizing indemnification had been met, Energy Maintenance contended that the jury's unfavorable verdict and the judgment against Nesler for fraud disproved his good faith and thereby provided a basis for the board to revoke its earlier grant of indemnity. The company relied on Delaware decisions construing that state's corporate indemnification

statute, 8 Del. Code § 145, for the proposition that a jury’s finding of fraud negates good faith as a matter of public policy. The court disagreed, noting that the statutes governing Delaware corporations and Delaware limited liability companies were different. Unlike Section 145, which applied to corporations, the statute governing limited liability companies allowed indemnity “against any and all claims and demands whatsoever,” subject only to the express terms of the company agreement. This statute did not purport to adopt or incorporate Delaware’s public policy regarding indemnity in the corporate context, and it deferred instead to the contracting parties to place limits on indemnification.

Although the court decided that the company was obligated to indemnify Nesler from liability in the Sandt litigation, it also concluded that Sandt, in a settlement agreement, agreed to forego any collection of the judgment against Nesler for which the company would be liable. The settlement agreement provided that Sandt “will not seek to execute and will not accept recovery, in each case whether directly or indirectly, against” Energy Maintenance for any remaining liability arising from the suit. The trial court reasoned that Energy Maintenance owed indemnity to Nesler, and thus an attempt to collect the remaining money that Nesler owed under the Sandt judgment would violate the settlement agreement’s clause barring Sandt from recovering any additional sum from Energy Maintenance “directly or indirectly.” In light of this clause and others, the court of appeals concluded that the trial court correctly interpreted the settlement agreement: “In sum, the settlement agreement bars Sandt from recovering from Nesler because it would result in an indirect recovery from Energy Maintenance, which is obligated to indemnify Nesler for the Sandt judgment.”

### **Information Rights**

*Succession of McCalmont*, 2018 WL 6521176, \_\_ So. 3d \_\_ (La. App. 3d Cir. 2018).

The court of appeals held that the executor of the estate of the deceased wife of a member of several LLCs was not entitled to the production of LLC business, financial, and tax records because neither the agreements nor the Louisiana LLC statute gave an assignee a right of access to the LLC’s books and records.

Colleen McCalmont filed for divorce from her husband James McCalmont (“James”) in August of 2016, but she passed away before the divorce was finalized or community property partitioned. One of the McCalmonts’ children, Jay McCalmont (“Jay”) was appointed executor of her estate. As part of the executor’s duties in preparing a detailed description of property in the succession, Jay sought information from James regarding property believed to be community property. After James refused to provide this information, Jay sought to compel discovery.

The trial court granted Jay’s motion to compel and ordered James to produce business, financial, and tax records of certain LLCs in which the McCalmonts had held an interest. The trial court also ordered James to comply with certain other discovery requests not involving the LLC. James appealed.

On appeal, James argued that the trial court erred in ordering the discovery of LLC documents because the operating agreement of one LLC specifically restricted assignees from inspecting records and the Louisiana Limited Liability Company statute did not entitle assignees to inspect the records of the other involved LLCs. The court cited several Louisiana law propositions, including: (1) “[a]n operating agreement, whether written or oral, governs the operations of an LLC; (2) “[i]n the absence of [an operating agreement], the default provisions of the Louisiana LLC statute govern”; (3) “[a]n operating agreement is contractual in nature; thus, it binds the members of the LLC as written and is interpreted pursuant to contract law”; (4) as to contractual interpretation, “[t]he interpretive purpose is to determine the common intent of the parties”; (5) the ordinary contract

interpretation rules apply, including the interpretation of “each contractual provision in light of the other provisions in order to arrive at the meaning of the contract as a whole”; and (6) “[t]he determination of whether the words of a contract are clear and explicit or ambiguous is a question of law [and thus] an appellate court’s determination on review is whether the trial court interpreted a contract correctly or incorrectly.” Applying an abuse-of-discretion standard, the court of appeals examined the evidence in the record. As to the discovery ordered against the LLCs, the court organized its analysis around whether the operating agreements dealt with maintenance of business records and the rights of an assignee. If the operating agreements addressed these issues, the court applied the pertinent provisions of the operating agreement; if not, the court applied the Louisiana LLC statute.

First, James argued, and the court agreed, that the operating agreement of one of the LLCs at issue specifically restricted assignees of a member from inspecting company records. Section 6.1 of the the operating agreement, titled “Books and Records,” required certain records (including those at the center of this dispute) “to be maintained and to be available to ‘any Member or an assignee of an Interest.’” On the other hand, Section 8.5 provided for the rights of unadmitted assignees as follows:

A person who acquires all or any portion of an Interest but who is not admitted as a Substituted Member ... shall be entitled only to allocations and distributions with respect to such interest ... but shall have no right to any information or accounting of the affairs of the company, shall not be entitled to inspect the books or records of the company, and shall not have any of the rights of a Member.

Interpreting the language from Section 6.1 and Section 8.5 in the manner that best conformed to the objectives of the operating agreement, the court determined that the specific provision of Section 8.5 controlled over the more generally worded Section 6.1. The court reasoned that to conclude otherwise would simply eliminate the effects of Section 8.5 entirely and lead to an “absurd” reading of the operating agreement as a whole. As a result, the court concluded that Jay, as an assignee, had “no right to any information or accounting of the affairs of the company, shall not be entitled to inspect the books or records of the company, and shall not have any of the rights of a Member.” Furthermore, the court concluded that it was clear the operating agreement prohibited Jay from receiving the business, financial, and tax records that were the subject of the trial court’s discovery order. Thus, the court of appeals held that it was an abuse of discretion for the trial court to order the LLC governed by this operating agreement to produce those records and reversed the order compelling discovery.

Next, the court analyzed James’ argument that the Louisiana LLC statute, which governed the remaining LLCs whose operating agreements were silent as to the rights of assignees of membership interests, expressly restricts assignees to statutorily limited rights that do not include the right to inspect the records of the LLC. The court began its analysis by pointing out that the Louisiana LLC statute recognizes only one form of transfer of a membership interest—an assignment—whether voluntary or involuntary. In the case of an involuntary assignment, as in the case of a member’s death, the deceased member is the assignor and the recipient of the transferred interest, such as the executor or other legal representative, is treated strictly as the assignee. The court explained that an assignment results in a bifurcation of membership rights: the financial rights vest with the assignee, while the management rights remain vested with the assignor, even if deceased, until the assignee is admitted as a member. Thus, the statute confers on the assignee only the limited right to receive those distributions and allocations of profits, losses, and tax items that

the assignor would otherwise have been entitled to receive. The court of appeals then relied on its decision in a 2004 case for the proposition that an assignee “is not entitled to inspect [the LLC’s] records, since this action is reserved for the members of the LLC.” The court acknowledged that “the law as written allows for the creation of situations whereby an assignee of a deceased member’s rights, while due distributions, may never be able to see company records to ensure he is actually receiving those distributions in full, because remaining members can simply withhold records that would show what, if anything, may be owed.” However, the court concluded that Louisiana LLC law clearly limited Jay’s rights as an assignee and compelled the court to hold that it was an abuse of discretion for the trial court to order the LLCs to produce the requested records. Thus, the court reversed the trial court’s order compelling discovery.

### **Interpretation of Operating Agreement or Partnership Agreement**

*Succession of McCalmont*, 2018 WL 6521176, \_\_ So. 3d \_\_ (La. App. 3d Cir. 2018).

The court of appeals held that the executor of the estate of the deceased wife of a member of several LLCs was not entitled to the production of LLC business, financial, and tax records because neither the agreements nor the Louisiana LLC statute gave an assignee a right of access to the LLC’s books and records.

Colleen McCalmont filed for divorce from her husband James McCalmont (“James”) in August of 2016, but she passed away before the divorce was finalized or community property partitioned. One of the McCalmonts’ children, Jay McCalmont (“Jay”) was appointed executor of her estate. As part of the executor’s duties in preparing a detailed description of property in the succession, Jay sought information from James regarding property believed to be community property. After James refused to provide this information, Jay sought to compel discovery.

The trial court granted Jay’s motion to compel and ordered James to produce business, financial, and tax records of certain LLCs in which the McCalmonts had held an interest. The trial court also ordered James to comply with certain other discovery requests not involving the LLC. James appealed.

On appeal, James argued that the trial court erred in ordering the discovery of LLC documents because the operating agreement of one LLC specifically restricted assignees from inspecting records and the Louisiana Limited Liability Company statute did not entitle assignees to inspect the records of the other involved LLCs. The court cited several Louisiana law propositions, including: (1) “[a]n operating agreement, whether written or oral, governs the operations of an LLC; (2) “[i]n the absence of [an operating agreement], the default provisions of the Louisiana LLC statute govern”; (3) “[a]n operating agreement is contractual in nature; thus, it binds the members of the LLC as written and is interpreted pursuant to contract law”; (4) as to contractual interpretation, “[t]he interpretive purpose is to determine the common intent of the parties”; (5) the ordinary contract interpretation rules apply, including the interpretation of “each contractual provision in light of the other provisions in order to arrive at the meaning of the contract as a whole”; and (6) “[t]he determination of whether the words of a contract are clear and explicit or ambiguous is a question of law [and thus] an appellate court’s determination on review is whether the trial court interpreted a contract correctly or incorrectly.” Applying an abuse-of-discretion standard, the court of appeals examined the evidence in the record. As to the discovery ordered against the LLCs, the court organized its analysis around whether the operating agreements dealt with maintenance of business records and the rights of an assignee. If the operating agreements addressed these issues, the court applied the pertinent provisions of the operating agreement; if not, the court applied the Louisiana LLC statute.



First, James argued, and the court agreed, that the operating agreement of one of the LLCs at issue specifically restricted assignees of a member from inspecting company records. Section 6.1 of the the operating agreement, titled “Books and Records,” required certain records (including those at the center of this dispute) “to be maintained and to be available to ‘any Member or an assignee of an Interest.’” On the other hand, Section 8.5 provided for the rights of unadmitted assignees as follows:

A person who acquires all or any portion of an Interest but who is not admitted as a Substituted Member ... shall be entitled only to allocations and distributions with respect to such interest ... but shall have no right to any information or accounting of the affairs of the company, shall not be entitled to inspect the books or records of the company, and shall not have any of the rights of a Member.

Interpreting the language from Section 6.1 and Section 8.5 in the manner that best conformed to the objectives of the operating agreement, the court determined that the specific provision of Section 8.5 controlled over the more generally worded Section 6.1. The court reasoned that to conclude otherwise would simply eliminate the effects of Section 8.5 entirely and lead to an “absurd” reading of the operating agreement as a whole. As a result, the court concluded that Jay, as an assignee, had “no right to any information or accounting of the affairs of the company, shall not be entitled to inspect the books or records of the company, and shall not have any of the rights of a Member.” Furthermore, the court concluded that it was clear the operating agreement prohibited Jay from receiving the business, financial, and tax records that were the subject of the trial court’s discovery order. Thus, the court of appeals held that it was an abuse of discretion for the trial court to order the LLC governed by this operating agreement to produce those records and reversed the order compelling discovery.

Next, the court analyzed James’ argument that the Louisiana LLC statute, which governed the remaining LLCs whose operating agreements were silent as to the rights of assignees of membership interests, expressly restricts assignees to statutorily limited rights that do not include the right to inspect the records of the LLC. The court concluded that Louisiana LLC law clearly limited Jay’s rights as an assignee and compelled the court to hold that it was an abuse of discretion for the trial court to order the LLCs to produce the requested records. Thus, the court reversed the trial court’s order compelling discovery.

*Nicolazzi v. Bone*, 564 S.W.3d 364 (Mo. Ct. App. 2018).

In a dispute regarding a member’s breach of an LLC operating agreement and alleged withdrawal from the company, the court of appeals concluded that: (1) the trial court did not err in finding that the member breached the operating agreement by failing to make his required initial capital contribution; (2) the trial court erroneously applied the law in finding that the member breached the operating agreement by discussing the sale of his interest with a third party without the consent of the other member; (3) the trial court erroneously applied the law in finding that the member’s actions prior to filing his petition constituted withdrawal from the LLC; (4) the trial court erred in determining that the other member was the sole member of the LLC; and (5) the member’s filing of his petition may have constituted an “event of withdrawal” as a matter of law.

Peter Nicolazzi and Laura Bone formed Young in Spirit Adult Day Care, LLC (the “LLC”), an adult daycare business, in 2005. Immediately following its formation, Nicolazzi and Bone were the LLC’s only workers and, under the operating agreement they signed in 2005, the only members. Nicolazzi was responsible for performing service-related tasks for the LLC’s customers and Bone

primarily performed managerial and nursing duties. When business expanded, Bone's duties grew while Nicolazzi's tasks were handled by employees that the company hired. As time went on, the parties' business relationship deteriorated. In 2011, Nicolazzi did not seek Bone's permission before he approached a competitor about buying his interest in the LLC. On April 30, 2011, Nicolazzi effectively stopped participating in the operation of the LLC, while Bone continued to operate the LLC. In June of 2011, Bone filed articles of incorporation for "Young in Spring Adult Day Center, Inc." and, on the next day, notified Nicolazzi that the business would continue in this new entity and that she would be dissolving the LLC.

On June 30, 2011, Nicolazzi filed his petition against Bone and requested: (1) a declaratory judgment determining whether Bone was still a member and whether she had misappropriated LLC funds, and ordering Bone to reimburse Nicolazzi for distributions received in excess of her fifty percent share; (2) a complete accounting from Bone of the LLC and the new business entity; and (3) judgment for the losses, expenses, and damages that Bone owed to Nicolazzi for his interest in the LLC. Among her counterclaims, Bone asked the trial court to find that Nicolazzi was no longer a member of the LLC because he breached the operating agreement by failing to make his required capital contribution and by soliciting purchase of his membership interest by a third party without her consent. After a bench trial, the trial court entered judgment in favor of Bone and against Nicolazzi, finding that Nicolazzi breached the LLC's operating agreement by failing to make the required capital contribution and by soliciting purchase of his membership interest without Bone's consent, and that his actions constituted "events of withdrawal" under the Missouri Limited Liability Company Act (the "Missouri LLC Act"). The trial court concluded that Nicolazzi was no longer a member of the LLC, that Bone was the sole member and owner of the LLC, and that Nicolazzi had been paid all salary and distributions the LLC owed to him. After Nicolazzi's motion for a new trial and amendment of the judgment was denied, he appealed.

Because Nicolazzi's arguments on appeal depended upon the application of the LLC's operating agreement and the Missouri LLC Act, the court cited a number of Missouri law propositions, including: (1) "[w]hile limited liability companies are creatures of statute, [the court] 'interpret[s] an L.L.C.'s operating agreement according to the ordinary rules of contract law"; (2) "[t]he primary rule of contract interpretation is to determine the intent of the parties and to give effect to that intent"; (3) "[i]n interpreting an operating agreement, [the court] applie[s] the plain and ordinary meaning of the words in the agreement and consider[s] the document as a whole"; and (4) "[w]here a contract's terms are clear and unambiguous, [the court will] enforce the agreement as written and will not supply additional terms." The court also cited the Missouri LLC Act for the requirement that member(s) adopt an operating agreement and the statutory definition of "member" as "any person that signs in person ... or otherwise is a party to the operating agreement at the time the [LLC] is formed and is identified as a member in that operating agreement..." The court reasoned that because Nicolazzi was named in the LLC's operating agreement, he signed the operating agreement when the LLC was formed, and the operating agreement did not establish any further condition or prerequisites to membership, then he was a member from that point forward. The court of appeals further concluded that Nicolazzi and Bone were the only members of the LLC throughout the company's existence.

The standard of review in this case required the court of appeals to affirm the trial court's judgment unless there was no substantial evidence to support it, it was against the weight of the evidence, or it erroneously declared or applied the law. The court organized its discussion around two primary issues: first, whether Nicolazzi breached the LLC's operating agreement; and second, whether Nicolazzi's actions constituted withdrawal from the LLC, leaving Bone as the sole member.

The first issue that the court of appeals addressed was whether the trial court erred in finding that Nicolazzi breached the LLC's operating agreement. Nicolazzi argued that the trial court's conclusion that he breached the operating agreement by failing to make his initial capital contribution was against the weight of the evidence. The LLC's operating agreement contained a provision requiring Nicolazzi and Bone to contribute capital in equal amounts, including "initial contributions" of \$50,000 each. However, no deadline was stated in the operating agreement and neither party testified that a due date had been agreed to otherwise. At trial, the parties presented "staggeringly" different amounts when providing evidence of Nicolazzi's cash and non-cash capital contributions during the five years between the LLC's formation and when he filed his petition: Bone and the LLC's CPA testified that he had contributed \$31,065, while Nicolazzi and his retained expert witness (who was also a CPA) testified that he had contributed \$79,271. In its judgment, the trial court justified its determination that the testimony on Bone's side was more credible and reliable by recognizing "inconsistencies and shortcomings" in Nicolazzi's purported contributions and that his expert's opinion was based on those facts. The trial court even noted that "[i]t was difficult at best, impossible at worst, to sort out [Nicolazzi's] personal finances from company business." Because the court's deference to the trial court's findings of facts in this case extended to credibility determinations of witnesses, the court of appeals held that the trial court's conclusion that Nicolazzi breached the LLC's operating agreement by failing to make his required initial capital contribution requirement was not against the weight of the evidence. The court of appeals noted that it was not necessary to analyze the meaning of the word "initial" in relation to the required capital contributions, despite the absence of a deadline in the operating agreement, because it was established at trial that both parties intended and understood the \$50,000 would be paid within six months of the execution of the LLC's operating agreement. The court further noted that under any definition of "initial," Nicolazzi's failure to make the required initial capital contribution within a five-year time span undoubtedly constituted a breach of the operating agreement. Therefore, the court of appeals affirmed the trial court's judgment in this regard.

Nicolazzi next argued that the trial court's conclusion that his attempt "to sell his interest in the business to a third party without [Bone's] written consent" constituted a breach of the operating agreement was a misapplication of law. Paragraph 7 of the LLC's operating agreement stated that "[n]either of the Members shall, without the written consent of the other Member, sell, assign, pledge, mortgage, or otherwise transfer [his] [her] interest in the LLC." However, the court observed that neither the operating agreement nor the Missouri LLC Act defined these prohibited actions. At trial, it was established that Nicolazzi did discuss a sale of his interest in the LLC with a third party without seeking Bone's permission, though Nicolazzi testified the discussion was to gauge how interested this buyer was in the potential sale. The court found that a plain reading of Paragraph 7 would prohibit the parties from the listed actions without the other member's written consent. However, the court distinguished between a *conveyance* and a *solicitation* and noted that the language of Paragraph 7 indicated that the parties intended to prohibit one another from conveying their membership interest without the other member's permission. On the other hand, neither Paragraph 7 nor any other provision of the operating agreement prohibited (or even addressed) a member's attempt to sell or to discuss a sale of his or her interest. The court observed that it was undisputed that Nicolazzi did not ever actually perform any of the actions listed in Paragraph 7, and Bone argued before the trial court that Nicolazzi breached the operating agreement by soliciting the purchase of his membership interest. The court concluded that the operating agreement did not necessitate that a member receive the other member's consent before soliciting purchase of the member's interest by a prospective buyer. Because the operating agreement lacked such language, the court of appeals found that the trial court's conclusion that Nicolazzi breached the operating

agreement by attempting to sell his membership interest to a third party without Bone's written consent was an erroneous application of the law. Therefore, the court reversed the trial court's judgment on this issue.

The second issue that the court of appeals addressed was whether the trial court erred in finding that Nicolazzi's actions constituted an "event of withdrawal" under the Missouri LLC Act and finding that Bone was the LLC's sole member. Nicolazzi argued that the trial court's conclusion that he withdrew was a misapplication of the Missouri LLC Act. The court of appeals observed that the trial court relied on two provisions of the Missouri LLC Act when it concluded that Nicolazzi's actions of failing to make his required initial capital contributions, attempting to sell his membership interest, and leaving the LLC in April of 2011 constituted "events of withdrawal." The Missouri LLC Act permits a member to withdraw from a LLC as specified in writing in the operating agreement, at any time upon giving ninety-days' prior written notice to the other members, or under certain conditions (e.g., assignment of a member's entire interest in the LLC or expulsion as a member in accordance with the operating agreement). Because the LLC's operating agreement was silent on what would constitute an event of withdrawal, Nicolazzi did not give any written notice to Bone, and the other statutory conditions were not present before Nicolazzi filed his petition, the court of appeals concluded that the trial court erroneously applied the two provisions of the Missouri LLC Act in finding that Nicolazzi's actions constituted "events of withdrawal" from the LLC. The court pointed out that while it did affirm the trial court's finding that Nicolazzi breached the operating agreement by failing to make his initial capital contribution, that breach did not equate to his withdrawal under the operating agreement or the Missouri LLC Act. As a result, the court of appeals reversed the trial court's judgment in that regard.

The court further concluded that Nicolazzi was still a member of the LLC at the time he filed his petition because he was a member when the LLC was formed and did not withdraw before filing. Therefore, the court of appeals reversed the trial court's determination that Bone was the sole member of the LLC. However, the court also found that, as a matter of law, Nicolazzi may have withdrawn from the LLC by actually filing his petition. Under the Missouri LLC Act, an "event of withdrawal" includes a member filing a petition "[s]eeking for himself any reorganization, arrangement, composition, readjustment, liquidation, or similar relief under any statute, law, or regulation ...." Because this issue was not before the trial court, the court of appeals remanded the case to that court with instructions to determine whether Nicolazzi's filing of his petition constituted an event of withdrawal. The court of appeals also found that the LLC's operating agreement did not state the amount or method for determining the distribution to be paid to a withdrawing member. Thus, if the trial court determined that Nicolazzi's filing of his petition constituted such an "event of withdrawal," then the court of appeals instructed the trial court to determine the "fair value" of Nicolazzi's interest in the LLC as of the date of withdrawal (the date that he filed his petition).

In sum, the court of appeals held that the trial court's conclusion that Nicolazzi breached the LLC's operating agreement by failing to make his required initial capital contribution was not against the weight of the evidence and affirmed the trial court's judgment in that regard. The court of appeals also held that the trial court erroneously applied the law in finding that Nicolazzi breached the LLC's operating agreement by discussing the sale of his interest with a third party without Bone's consent and in finding that Nicolazzi withdrew from the LLC prior to the filing of his petition, reversing the trial court's judgment on these issues. Because the court of appeals found that Nicolazzi did not withdraw from the LLC prior to the filing of his petition, the court also found that the trial court erred in determining that Bone was the sole member of the LLC and reversed the trial court's judgment in that regard. Finally, as a matter of law, the court of appeals found that Nicolazzi's actual filing of his petition may itself have constituted an "event of withdrawal." Because this issue was

not before the trial court, the court of appeals remanded the case to the trial court to determine if Nicolazzi withdrew pursuant to the Missouri LLC Act, and if he did, to determine the “fair value” of his interest in the LLC at the time of withdrawal.

*VanWinkle v. Walker*, No. 2016-CA-000097-MR, 2018 WL 4043388 (Ky. Ct. App. 2018).

The court of appeals held that the operating agreement of a Kentucky LLC unambiguously required a member to pay an amount equal to one-third of the LLC’s liabilities based on a provision of the operating agreement that divided the “profits and liabilities” of the LLC equally between the three members.

In 2004, Troy VanWinkle, Lyle Walker, and Carl David Crawford formed TLC Developers, LLC (“TLC”), and executed an operating agreement. TLC’s business purpose was to develop and build residential structures in Madison County, Kentucky. Several years later, TLC experienced severe cash-flow problems and was unable to pay its business expenses. Because Walker and Crawford believed that the operating agreement required the members to pay equally for these expenses if TLC could not, they contributed personal funds to the company’s account. VanWinkle claimed that he was not required to pay expenses of TLC, although he did pay one-third of TLC’s property taxes on multiple occasions.

In 2013, Walker and Crawford filed a complaint seeking a declaration of rights as to the members’ dispute over the agreement to equally pay TLC’s liabilities. After a bench trial, the circuit court determined that the operating agreement unambiguously stated that the three members agreed to split company liabilities in thirds and ordered VanWinkle to pay \$87,000 as his one-third share of TLC’s liabilities.

On appeal, VanWinkle argued that the circuit court erred because: (1) the operating agreement contained an express provision protecting the members from personal liability; and (2) holding the members personally liable for TLC’s liabilities would be inconsistent with the intent of the Kentucky Limited Liability Company Act (the “Kentucky LLC Act”).

The court’s analysis of VanWinkle’s first argument focused on two separate provisions in the TLC operating agreement. One of these provisions, titled “Immunity from Personal Liability” (the “Immunity provision”), stated:

As provided in [Kentucky LLC Act] 275.150, no member, employee or agent of the Company will be personally liable by reason of such status under a judgment, decree, or order of a court or agency, or tribunal of any type, or in any other manner, in this or any other state, or on any other basis, for a debt, obligation, or liability of the Company, whether arising in contract, tort, or otherwise. The status of a person as a Member, employee or agent of the Company shall not subject the person to personal liability for the acts or omissions, including any negligence, wrongful act, or actionable misconduct, of any other Member employee or agent of the company.

The other provision, titled “Division of Profits and Liabilities” (the “Division provision”), stated:

The profits and liabilities of the Company shall be divided as follows: Carl David Crawford = thirty-three and one-third (33 1/3%), Lyle A. Walker = thirty-three and one-third (33 1/3%) percent and Troy Van Winkle [sic] thirty-three and one-third (33 1/3%).

VanWinkle contended that the Immunity provision acted “as a shield against *any* personal liability arising from” TLC’s liabilities, despite the existence of the Division provision. The court disagreed, first noting that the Immunity provision was “almost identical” to Section 275.150(1) of the Kentucky LLC Act, which does, in general, limit personal liability of members of an LLC. Because of this direct reference to a specific statute, the court concluded that the members “clearly” intended to mimic Section 275.150. Second, the court noted that VanWinkle appeared to ignore Section 275.150(2), which states that the members may alter the general rule of nonliability by agreeing to be personally obligated for the liabilities of the LLC in a written operating agreement. The court concluded that Section 275.150(2) was articulated in the TLC operating agreement under the Division provision. Third, the court referenced case law for the requirement that “[a]ny such assumption of personal liability . . . must be stated clearly in *unequivocal language* which leaves no room for doubt about the parties’ intent[,]” citing *Racing Inv. Fund 2000 v. Clay Ward Agency*, 320 S.W.3d 654, 659 (Ky. 2010) (emphasis added). The court concluded that the language of the second provision met this “unequivocal language” standard because the Division provision unambiguously mandated that TLC’s liabilities be divided evenly between the three members, and the provision appeared on the same page of the agreement that VanWinkle signed. The court also pointed out that, because VanWinkle previously paid his share of the company’s property taxes on at least two occasions, it appeared that “he understood this provision at one point in time.” As a result, the court rejected VanWinkle’s first argument.

The court then turned to VanWinkle’s argument that he could not be personally liable for TLC’s liabilities because “the hallmark of an LLC—and [the Kentucky LLC Act, by extension]—is to limit the liability of LLC members.” The court agreed that members are not, as a general rule, liable for the liabilities of the LLC under the Kentucky LLC Act. However, the court pointed out that Section 275.003 of the Kentucky LLC Act provides that it is the policy of the statute “to give maximum effect to the principles of freedom of contract and the enforceability of operating agreements” to allow business partners the freedom to contract and structure an LLC to fit the needs of its members. The court noted that holding the members personally liable for TLC’s liabilities may seem contrary to the point of establishing an LLC, but this result adhered to the legislative intent of allowing members the freedom to contract and establish an LLC that fits their needs. Here, the three members each agreed to the equal division of TLC’s liabilities, and the circuit court thus did not err in ordering VanWinkle to pay his agreed-upon share of the company’s liabilities.

***Pak v. AD Villarai, LLC***, No. 05–14–01312–CV, 2018 WL 2077602 (Tex. App. 2018).

The court of appeals held that the removal of an individual as co-manager of an LLC was effective where half of the members signed a written consent voting to remove the individual as manager, and the remaining members (one of whom was the individual who was being removed) did not object after receiving written notice of the written consent. The court also held that the subsequent expulsion of the individual as a member from a related LLC was valid under the terms of the company agreement of that LLC.

Pak was the majority member of Villas on Raiford Carrollton Senior Housing, LLC (“Villas CSH”) and Villas on Raiford, LLC (“Villas Manager”), the ownership and management entities of a low-income senior housing project. Pak and AD Villarai, LLC, an entity controlled by Anderson, were co-managers of Villas Manager. After various acts of mismanagement by Pak came to light, the Villas entities sued Pak. Certain members of Villas Manager took action to remove Pak as a manager and member of that entity, and members of Villas CSH subsequently took action to expel Pak as a member from that entity. The issues were tried in a bench trial, and the trial court concluded that Pak was validly removed as co-manager of Villas Manager and that Pak breached his fiduciary

duties to Villas CSH and Villas Manager and materially breached the company agreements of each entity. However, the trial court found that the member consent expelling Pak as a member of Villas CSH did not comply with the company agreement and was not effective. Both sides appealed.

On appeal, Pak argued that his removal as co-manager of Villas Manager was not effective because he did not vote as a member in favor of his removal as a manager. The company agreement provided for the removal of a manager with the vote of a majority of the members and defined a majority as more than 50% of the number of members. At the time, Villas Manager had four members, and two of them signed a written consent removing Pak as a manager and member and appointing AD Villarai, LLC as sole manager of Villas Manager. The company agreement of Villas Manager contained a provision authorizing action by the members without a meeting as follows:

Any action required by the BOC [Business Organizations Code] to be taken at a meeting of the Members, or any action which may be taken at a meeting of the Members, may be taken without a meeting, without prior notice, and without a vote if a written consent or consents in writing, setting forth the action so taken, shall have been signed by the Members entitled to vote with respect to the action which is the subject matter of the consent, and such consent shall have the same force and effect as a unanimous vote of the Members.

This provision additionally required that a written consent be signed, dated, and delivered as required by the BOC. Finally, the provision stated that “prompt notice” of any action taken by members without a meeting by less than unanimous consent must be given to those members who did not consent in writing to the action. The court stated that the provision thus contemplated situations in which members would take action without a meeting and without unanimous written consent. In such cases, the agreement required that “prompt notice” be given to those who did not consent, but the agreement did not address the effect of giving such notice. The court then discussed Section 101.359 of the Texas Business Organizations Code, which governs an LLC unless the LLC’s company agreement provides otherwise. Section 101.359 provides that members and managers may take action without a meeting in various ways, and Section 101.359(2)(A) provides that an action is effective if it is taken with the consent of each member, “which may be established by: (A) the member’s failure to object to the action in a timely manner, if the member has full knowledge of the action.” Because nothing in the company agreement of Villas Manager provided that consent could not be established by failure to object as provided by the statute, and the plain wording of the company agreement did not conflict with applying the statute to the member actions in this case, the court concluded that a member’s failure to object after being given written notice of the written consent was deemed consent to the action taken by the written consent such that the action became effective. The evidence showed that Pak and the other member who did not sign the written consent were given written notice three days after the action removing Pak as co-manager, and neither of them objected. Pak argued that the written consent was signed while the two sides were in litigation, and the trial court could not have reasonably concluded that Pak would have consented to his removal, but the court of appeals stated that the statute did not require the trial court to guess at Pak’s reasons for failing to object. Thus, the court of appeals concluded that Pak was validly removed as co-manager of Villas Manager.

The court of appeals also addressed the trial court’s conclusion that Pak’s expulsion as a member of Villas CSH failed to comply with the terms of the company agreement, and the court of appeals held that the evidence conclusively established that Pak was properly expelled. The company agreement of Villas CSH contained the following expulsion provision:

If a Member willfully violated any term of provision of this Agreement and fails or cannot cure such violation within ten (10) business days after having been given notice of the violation by the Company, then the Managers shall have the right, but not the obligation, to expel such Member as a Member of Company, provided, however, that the remaining Members unanimously vote to expel such Member.

The undisputed evidence showed that Pak was given notice of specified violations of the company agreement and that sixteen days later, after Pak failed to cure all the violations, a written consent expelling Pak as a member of Villas CSH was signed by AD Villarai, LLC—the remaining manager of Villas Manager (the manager of Villas CSH)—and the three other members of Villas CSH. The court of appeals explained that the trial court had erroneously concluded that Pak’s vote as well as that of AD Villarai, LLC was required for Villas Manager to act. Although Pak and AD Villarai, LLC had been co-managers of Villas Manager, Pak was validly removed as co-manager of Villas Manager several months before the execution of the written consent expelling Pak as a member from Villas CSH. Thus, at the time of Pak’s expulsion, AD Villarai, LLC was the sole manager with authority to act for Villas Manager. Once AD Villarai, LLC, as sole manager of Villas Manager, voted to expel Pak, the company agreement required the “remaining” members to vote unanimously to expel Pak. The court stated that it was clear in this context that “remaining” members meant members other than Pak. The consent was signed by the three members other than Pak as well as Villas Manager as the manager of Villas CSH. Thus, the court held that the written consent properly expelled Pak as a member.

*Abdullatif v. Choudhri*, 561 S.W.3d 590 (Tex. App. 2018).

In a dispute regarding the ownership of a limited partnership and its general partner, the court of appeals concluded that: (1) the trial court erred in submitting a jury question inquiring whether the parties to written assignments of interests in the limited partnership and its LLC general partner agreed to an alleged oral condition because the alleged condition contradicted the unambiguous terms of the assignments and was thus precluded by the parol evidence rule; (2) the language of certain assignments did not transfer any interest in the LLC general partner of the limited partnership; (3) certain purported transfers of interest in the LLC general partner were null and void ab initio because they were prohibited under the company agreement, and subsequent consent or ratification could not operate to give life to an attempted transfer that was null and void; (4) certain purported transfers of interests in the limited partnership were valid even if the transfers were prohibited by the partnership agreement because the partnership agreement allowed the general partner to recognize a transfer that would otherwise be null and void under the terms of the agreement.

Osama Abdullatif (“Latif”) and Ali Mokaram entered into a real estate investment venture by forming Mokaram Latif West Loop, L.P. (“ML Partnership”) in which Mokaram and Latif were each 49.5% limited partners and Mokaram-Latif General, LLC (“ML General”) was the 1% general partner. Mokaram and Latif were the managers and equal members of ML General. Mokaram and Ali Choudhri became friends and engaged in business transactions together, including transactions in 2008 and 2010 involving ML Partnership and ML General.

The 2008 transaction included an agreement in which Mokaram purported to transfer to Choudhri a limited partnership interest in ML Partnership, and the 2010 transaction included purported assignments by Mokaram to Choudhri of interests in ML Partnership and ML General. Disputes regarding these transactions arose, and eventually Latif purchased all of Mokaram’s interests in ML Partnership and ML General along with all of Mokaram’s claims against Choudhri



relating to interests in the entities. Mokaram agreed to continue to pursue his claims against Choudhri in this lawsuit in which Mokaram, Latif, Choudhri, and ML Partnership were parties. The trial court entered a declaratory judgment regarding the ownership of the entities, and Mokaram and Latif appealed.

The first issue the court of appeals addressed was whether the trial court erred in submitting a jury question inquiring whether Mokaram and Choudhri agreed that the 2010 assignment was not effective and that Mokaram would return the money paid by Choudhri to Mokaram. Because the unambiguous language of the assignment provided that it was effective immediately and did not indicate that it was contingent on any condition, the court of appeals concluded that the testimony regarding an alleged oral condition was precluded by the parol-evidence rule from contradicting the unambiguous language of the assignment. Thus, the trial court should not have submitted any question inquiring into the enforceability of the oral condition. The court stated that the parol-evidence rule would not have precluded the trial court from submitting a question about an alleged subsequent agreement to rescind, but the jury question that was submitted did not ask about a subsequent agreement to rescind. The court also stated that the evidence did not raise a genuine fact issue as to whether Mokaram and Choudhri agreed to rescind the assignment after they executed it.

The court next addressed the argument that the trial court lacked jurisdiction over the declaratory judgment claims regarding Choudhri's ownership and management rights in ML General because ML General was not a party. The court of appeals held that the trial court did not lack jurisdiction over the claims. Although the declaratory judgment did not bind ML General, it was binding on the parties in this action.

Next the court of appeals discussed whether the trial court erred in declaring that Choudhri had owned an interest in ML General since the date of the 2008 assignment. Based on the language of the documents executed in 2008, which purported to transfer to Choudhri an interest in ML Partnership and certain real property, the court concluded that Mokaram did not purport to transfer any interest in ML General. The documents indicated that Mokaram and Choudhri thought that ML Partnership owned the real property referred to in the assignments and that they intended to transfer an indirect interest in the real property by transferring an interest in ML Partnership. However, assuming that ML Partnership owned the real property referred to in the assignments, that would not mean that ML General had any ownership in the property, and the court concluded that the evidence did not show that Mokaram transferred any interest in ML General to Choudhri by virtue of the 2008 assignments.

The 2010 assignments purported to transfer from Mokaram to Choudhri interests in both ML General and ML Partnership. Both the company agreement of ML General and the partnership agreement of ML Partnership contained restrictions on transfer, and the court discussed the effect of the purported transfers by Mokaram.

The ML General company agreement prohibited a member from transferring any of its membership interest except in limited circumstances, such as with the approval of members having more than 66.67% of the interests of all members. The company agreement stated that a transfer in violation of its provisions was "null and void ab initio." Assuming Mokaram's execution of the assignments represented his approval of the transfers, there was no evidence that Latif, the other 50% member at the time, approved the assignments before Mokaram purported to assign his interest, and there was no evidence that any of the other circumstances under which a transfer was permitted were present. Choudhri relied on a 2011 consent signed by Latif as manager and member of ML General in which Latif consented to any prior transfers by Mokaram to Choudhri of a membership interest in ML General. The court concluded that the purported assignments were null and void from the outset under the unambiguous language of the company agreement, and as such the purported

transfers could not be ratified or validated after the fact. Thus, the trial court erred in declaring that Choudhri had owned 50% of ML General and had been a manager of ML General from and after the 2010 assignments.

The ML Partnership agreement also contained prohibitions on transfer, and the court next addressed the effect of purported assignments in 2010 by Mokaram to Choudhri of a limited partnership interest in ML Partnership. Section 10.1 of the partnership agreement prohibited a limited partner from transferring all or any portion of the limited partner's interest without the prior written consent of the general partner. Section 10.2 of the partnership agreement contained a right-of-first-refusal provision in favor of the other partners in the event a limited partner received a bona fide offer to purchase all or any portion of the limited partner's interest. Section 10.3 provided for certain "Permitted Transfers" (to a trust for the benefit of the limited partner, the guardian or estate of a limited partner, or a person approved by all the partners) notwithstanding the consent otherwise required by Section 10.1. Section 10.6 provided that a transfer that was not permitted under the partnership agreement "shall be null and void and of no effect whatever; provided that if the Partnership is required to recognize a Transfer that is not permitted (or if the Partnership, in its sole discretion, elects to recognize a Transfer that is not permitted)," the transferred interest was limited to the transferor's rights to allocations and distributions. Finally, Section 10.10 provided that the partnership was not required to recognize the interest of any transferee who obtained a purported transferred interest pursuant to a transfer that was not authorized by the partnership agreement, and such a transfer was "null and void for all purposes."

The court stated that the plain meaning of "null and void and of no effect whatever" would preclude a transfer that was not permitted by the partnership agreement from being subject to ratification, confirmation, or waiver, but the court concluded that the phrase "null and void and of no effect whatever" was not used in its ordinary sense given that the agreement unambiguously provided that the partnership could elect to recognize a transfer that was not permitted and thus was or would have been "null and void and of no effect whatever." The court noted the difference between the ML General company agreement (which the court had held did not permit ratification of a null and void transfer) and the ML Partnership agreement and concluded that the two agreements were separate and independent agreements that should not be construed together as one. Further, assuming the agreements should be construed as a single contract, the provisions unambiguously allowed the recognition of an otherwise void transfer of a partnership interest but did not allow the recognition of a void transfer of a membership interest.

Because Mokaram signed the assignment of his interests to Choudhri not only as assignor, but in his capacity as manager of ML General, the general partner of ML Partnership, under a legend stating that the transfer was consented to by the general partner, the court concluded that ML Partnership recognized the transfer of the interests. Relying on the language of the ML General company agreement (which provided that the managers shall have the sole and exclusive control of the management of ML General and shall make all decisions not otherwise provided for in the company agreement) and Section 101.254 of the Business Organizations Code (which provides that each governing person is an agent of the LLC for the purpose of its business), the court stated that Mokaram's signature as manager was binding on ML General, and ML Partnership thus recognized the transfer as valid and effective as provided by Section 10.6 of the partnership agreement. The court concluded that an earlier purported transfer in 2008 by Mokaram to Choudhri of a limited partnership interest was not effective because there was no evidence that the transfer was permitted under any of the provisions of the partnership agreement nor was there any evidence that the partnership was required to recognize the transfer or exercised its discretion to recognize the transfer.

Finally, the court concluded that the trial court did not err in refusing to clarify what rights Choudhri had as a result of his ownership of an interest in ML Partnership. The trial court declared that Choudhri owned 49.5% of ML Partnership from and after the 2010 assignments and that he had “all beneficial rights and interests” that flowed from his ownership of an interest in ML Partnership. The court stated that the interests transferred to Choudhri were limited to rights to allocations and distributions under the unambiguous language of Section 10.6 of the partnership agreement, and neither Section 10.2 nor 10.6 gave Choudhri the right to become a limited partner under the assignments. The trial court did not declare that Choudhri was a limited partner, and although the “beneficial rights and interests” were significantly limited by the agreement, the trial court did not inaccurately characterize them. Thus, the court of appeals concluded that the trial court did not err in making the declaration and in refusing to clarify it.

*Sohani v. Sunesara*, 546 S.W.3d 393 (Tex. App. 2018).

The court of appeals held that the trial court erred in entering a judgment that a member of three LLCs was entitled to one-third of the profits of each of the LLCs because the Texas Business Organizations Code provides that profits and losses are allocated to the members based on the agreed value of the members’ contributions as stated in the company’s records, and none of the LLCs had a record of the member’s alleged contribution. Although the member testified that he contributed cash to the LLCs, and the jury found that the member was entitled to a one-third profit distribution from each LLC, the court of appeals stated that allowing the member’s oral testimony to establish his entitlement to one-third of the profits of the LLCs in the absence of any written records of his contributions would be contrary to the plain language of the LLC statute.

Nizar Sunesara and Anis Virani started selling smoking accessories and devices in flea markets on the weekends in 2002, and the next year they established a brick-and-mortar retail shop called “Zig Zag Smoke Shop.” Sunesara created MNA Corporation to operate Zig Zag, and Virani and Sunesara offered Manisch Sohani (a supplier of Zig Zag) an ownership interest in the business. The three men each owned one third of MNA Corporation, and profits of Zig Zag were distributed in cash each month. Sunesara and Virani both took positions with Sohani’s company, and Sunesara transitioned out of the day-to-day business of Zig Zag while Virani continued to manage Zig Zag’s day-to-day operations as well as working for Sohani’s company. Zig Zag did well, and in 2012, Virani and Sunesara started a second retail location, which they called “Burn Smoke Shop” (“Burn I”). Sunesara testified that he contributed \$10,000 cash to the start up of Burn I. He stated that he gave the money to Virani and did not request any receipt or documentation of his contribution. SSV Corporation, which was incorporated by Sunesara in 2007, owned the assets of both Zig Zag and Burn I. Sunesara and Virani each owned 50% of SSV Corporation, but records showed that Sohani shared equally with Sunesara and Virani in profit distributions, and Sunesara testified that Sohani was considered a partner even though he was not a formal owner.

Toward the end of 2012, Sunesara, Virani, and Sohani agreed to buy an existing retail smoke shop, whose name they changed to “Burn Smoke Shop Two” (“Burn II”). Sunesara testified that he contributed \$10,000 cash to the start up of Burn II, again giving the money to Virani without obtaining any receipt or documentation of his contribution. Before the purchase of Burn II was finalized, Sohani and Virani asked Sunesara to file paperwork with the Texas Secretary of State to form three LLCs to run the three smoke shops. Each certificate of formation, which was signed by Sunesara but not the other two men, listed Sohani, Virani, and Sunesara as governing persons. Signature cards and depository resolutions for the bank accounts for the three LLCs listed all three men as members and were signed by all three men. Virani and Sohani claimed that Sunesara handled the paperwork for forming the LLCs and opening the bank accounts, and Virani and Sohani claimed

that they should have been listed as the only two members of the LLCs. The franchise tax public information report for 2013 listed all three men as members of the LLCs, but the franchise tax report for 2014 as well as federal income tax returns for 2013 and 2014 only listed Virani and Sohani as members or owners of the LLCs.

Sohani and Virani testified that Sunesara did not contribute anything to the three shops. They also testified that they never received any profit distributions from the LLCs because the profits went to Sohani's company to pay back inventory Sohani contributed and to pay other vendors and creditors of the LLCs.

After federal law enforcement officers began targeting sellers of synthetic marijuana and raiding retailers, wholesalers, and distributors in the smoke shop industry, Sunesara became concerned because Sohani's company and the three retail shops sold synthetic marijuana. Sunesara wanted Sohani's company and the shops to stop selling the product. Sohani's company was raided in 2013, and Sunesara took a leave of absence from the company and did not return. After the raid, Sohani and Virani realized that they lacked important documentation for the LLCs, such as operating agreements, and (after conducting internet research) the two men drafted and signed form operating agreements listing them as members and stating that they each made 50% of contributions and owned 50% of profits and assets. Sunesara's name did not appear in any of the three agreements, and he was not involved in the drafting of the agreements. Sunesara testified that he received monthly profit distributions for the first five months of 2013 and inquired regularly "what the situation was with profit distributions" after the raid but was given excuses why there were no distributions until October of 2013, when the parties ceased communicating. The parties disagreed over whether Sunesara had a share of the business, and Sohani and Virani were unable to open new bank accounts or obtain loans for the LLCs without Sunesara's authorization and signature. In 2015, Virani and Sohani sued Sunesara asserting various causes of action, including a claim for a declaratory judgment that Sunesara was not a member of the LLCs. Sunesara counterclaimed for a declaration that he was a member of the LLCs, was entitled to one-third of the profits of the LLCs, and was entitled to examine the LLCs' books and records.

The jury answered "yes" to three questions inquiring whether Sunesara was a member entitled to a one-third profit distribution of each of the LLCs at the time they were formed. No definitions or instructions accompanied these questions. The jury also found that Sohani and Virani were estopped to deny Sunesara was a member of the LLCs and that Sunesara did not commit fraud against Virani and Sohani. After the verdict, Virani and Sohani moved to dismiss the action for lack of subject-matter jurisdiction based on documentation that they argued demonstrated the combined total of one-third profit distributions from the three LLCs exceeded \$200,000, the upper limit of the county court's jurisdictional limits. Sohani and Virani also argued that Sunesara presented only his self-serving testimony that he was a member and had made contributions to the LLCs but presented no evidence of an oral or written operating agreement entitling him to membership and one-third of the profits of the LLCs. Virani and Sohani relied on Tex. Bus. Orgs. Code § 101.201, which provides that profits and losses of an LLC shall be allocated on the basis of the agreed value of the contributions made by each member, as stated in the company's records. The trial court entered judgment in favor of Sunesara declaring that he was a member of the LLCs and entitled to one-third of the profits from the LLCs.

The court of appeals analyzed the contention of Sohani and Virani that the trial court's judgment, which declared that Sunesara was a member of each of the LLCs and was entitled to one-third of the profits from each of the LLCs, conflicted with Section 101.201 of the Business Organizations Code, which states that an LLC's allocation of profits and losses are to be made "on the basis of the agreed value of the contributions made by each member, as stated in the company's

records.” Sohani and Virani argued that there was no written record reflecting Sunesara’s contributions to the LLCs or demonstrating that he was entitled to one-third of the profits. The court reviewed the definitions of a “member,” “membership interest,” “governing documents,” “company agreement,” and “contribution,” and pointed out that the Business Organizations Code does not require a person to make a contribution in order to be admitted as a member or acquire a membership interest. The court also pointed out that the statutory provisions addressing allocation of profits and losses and the sharing of distributions provide that such matters are based on the agreed value of each member’s contributions as stated in the company’s records required to be kept under the statute. Tex. Bus. Orgs. Code §§ 101.201, 101.203. Section 3.151 of the Business Organizations Code contains general recordkeeping requirements for filing entities, and Section 101.501 has specific requirements for LLCs that include maintaining a record of “the amount of a cash contribution and a description and statement of the agreed value of any other contribution made or agreed to be made by each member.” Tex. Bus. Orgs. Code § 101.501(a)(7).

The court’s analysis of Sohani’s and Virani’s contention focused on the “plain meaning” of Sections 101.201 and 101.501 of the Business Organizations Code. At trial, Sunesara testified that he made contributions to the LLCs in the form of \$10,000 cash contributions and “deferred profits” to the startup of Burn I and the acquisition of Burn II. Sunesara did not, however, offer any documentary evidence reflecting those contributions. The record contained no writing setting out the specific contributions made by any of the three members or stating that Sunesara was entitled to one-third of the profits from the LLCs. The company agreements for each of the LLCs were admitted into evidence, but they listed only Sohani and Virani as members and stated, under each of their names, “Made 50% of contributions, Owns 50% of profits and assets.” The court construed Section 101.501 of the Business Organizations Code to require an LLC to include a statement of the amount of cash contributions made by each member and a statement of the agreed value of any other contribution made by each member in the written records of the company and construed Section 101.201 to provide that these records establish the allocation of a member’s share of the profits and losses of the company. Because Sunesara did not introduce any records of the LLCs reflecting the contributions that he made to the LLCs, the court concluded that he presented no evidence that he is entitled to one-third of the profits of the LLCs under Section 101.201.

Sunesara argued that his testimony that he made contributions to the LLCs sufficed to demonstrate his entitlement to one-third of the profits of the LLCs, but the court stated that the plain language of Section 101.201 requires profits and losses to be allocated on the basis of the agreed value of the contributions made by each member, as stated in the company’s records required under Section 101.501, and the plain language of Section 101.501 requires an LLC to maintain a written record of the amount of a cash contribution and a description and statement of the agreed value of any other contribution made or agreed to be made by each member.

Sunesara pointed to the 2008 tax return of MNA Corporation (which stated that Sunesara, Virani, and Sohani were each allocated one-third of the profits for that corporation) and the records of SSV Corporation (which stated that Sunesara and Virani each owned fifty percent of that corporation) and argued that, when the LLCs were created and took over operation of the smoke shops, these records became a part of the records for the LLCs and satisfied the writing requirement of Section 101.201. But the court stated that the corporations and LLCs were all separate and distinct entities, and Sunesara cited no law supporting the proposition that the records from the earlier-formed entities became records of the new LLCs when they began operating the smoke shops. The court stated that the documentary evidence reflecting that Sunesara had a one-third ownership interest in MNA Corporation and a one-half interest in SSV Corporation established only that he was entitled to distributions from MNA Corporation and SSV Corporation, not that he made

contributions to the LLCs or that he was entitled to one-third of the profits from the LLCs. Thus, the court held that the trial court erred to the extent that it ruled that Sunesara was entitled to one-third of the profits from each of the LLCs. “Because Sunesara was not assigned a share of profits in the company agreements and presented no evidence that he was entitled to a one-third share of profits in the LLCs, he was not entitled to a share in profits as a matter of law.”

*Tangas v. Int’l House of Pancakes, LLC*, 298 F. Supp. 3d 1116 (N.D. Ohio 2018).

A former employee sued a restaurant-chain LLC and its parent corporation seeking indemnification for expenses incurred in defending against federal charges. The district court held that the former employee was not entitled to indemnification under the governing documents of either entity and the business judgment rule protected the LLC’s decision to deny indemnification on the grounds that the former employee engaged in fraud and willful misconduct.

Autumn Lee Tangas began working for International House of Pancakes, LLC (“IHOP”) in 1991 and became a “franchise bureau consultant” (FBC) in 2003. As an FBC, Tangas acted as a liaison to franchisees who operated restaurants in her multi-state territory, helped franchisees boost sales, and ensured that they adhered to IHOP operating standards. In September 2011, the FBI raided the home of a franchisee whose operations Tangas oversaw. After the raid, IHOP opened its own investigation to determine if the company itself might be a target of the FBI investigation or a potential victim of wrongdoing. In 2012, DineEquity’s in-house counsel communicated to Tangas’s lawyer that Tangas was obligated to cooperate with the internal investigation under the IHOP code of conduct and a refusal to do so would result in termination. After Tangas’s lawyer responded that Tangas would not answer any questions, IHOP fired Tangas for violating the IHOP code of conduct and refusing to participate in the interview. A federal grand jury subsequently indicted Elkafrawi, Tangas, and others. The indictment, which charged Tangas with money laundering, conspiring to harbor illegal aliens, and mail fraud, essentially alleged that Tangas used her position as an FBC to hide Elkafrawi’s criminal activities from IHOP. The criminal case against Tangas proceeded for more than two years until the U.S. Attorney’s Office dismissed the charges without prejudice in 2014. At that time, Tangas had incurred more than \$130,000 in legal fees. In 2015, Tangas demanded that IHOP pay these legal fees. After the FBI provided part of its investigative file to IHOP, the LLC denied her request in light of “the allegations in the indictment and supported by the evidence in the government interviews.”

After rejecting Tangas’s argument that she was entitled to indemnification under DineEquity’s bylaws or the Delaware corporate statute, the district court addressed whether Tangas had a right to indemnification under IHOP’s LLC agreement. Both sides relied on the language of IHOP’s LLC agreement, which provided that:

the Company shall indemnify and hold harmless each Covered Person from and against any and all losses, claims, demands, liabilities, expenses, judgments, fines, settlements and other amounts arising from any and all claims, demands, actions, suits or proceedings, civil criminal administrative or investigative (“Claims”), in which the Covered Person may be involved, or threatened to be involved as a party or otherwise, by reason of its management of the affairs of the Company or which relates to or arises out of the Company or its property, business or affairs. A Covered Person shall not be entitled to indemnification under this Section 8.2 with respect to (i) any Claim with respect to which such Covered Person has engaged in fraud, willful misconduct, bad faith or gross negligence[.]

The LLC agreement defined “Covered Persons” to include “the Member [i.e., DineEquity], any officers, directors, stockholders, partners, employees, affiliates, representatives, or agents of any of the Member,” or “any officer, employee, representative, or agent of the Company [i.e., IHOP].” Because the parties agreed that Tangas was a “Covered Person” until she was fired in 2012, the court focused on determining if Tangas was entitled to indemnification of expenses incurred post-termination.

DineEquity and IHOP argued that Tangas’s indemnification rights did not continue post-termination because the Delaware LLC statute, unlike the corporate statute, does not provide a default rule that requires continuation of indemnification rights after a person ceases to be an employee, and such rights were not provided in IHOP’s LLC agreement. Tangas argued that IHOP impliedly agreed to cover expenses of former employees by failing to specify that the indemnification clause does not exclude former employees, but the court was not persuaded by Tangas’s interpretation of the indemnification clause because the interpretation was logically flawed (all categories of persons not defined as “Covered Persons” could claim indemnification) and unsupported by case law (absent explicit language inclusive of former employees, Delaware courts interpret “employee” as referring to current employees only). The court noted that the operating agreement had a provision limiting IHOP’s ability to amend the agreement to strip Covered Persons of their existing indemnification rights, but the language forbidding IHOP from retroactively stripping a Covered Person of existing indemnification rights did not prohibit IHOP from discontinuing indemnification once a person ceased to be a Covered Person. Tangas also argued that she had a vested right to indemnification that continued after her firing, but the court distinguished Delaware cases in which the courts determined that an indemnification right became vested and could not be terminated. The only right that could have vested in this case was Tangas’s right to be indemnified while she was a Covered Person involved or threatened to be involved in a proceeding. Because Delaware law did not prohibit IHOP from limiting its indemnification obligations in this manner and nothing in the LLC agreement required IHOP to indemnify a former employee whom it had fired, Tangas was not entitled to indemnification under the IHOP LLC agreement as a matter of law.

Finally, assuming *arguendo* that IHOP’s LLC agreement required it to indemnify Tangas, the district court addressed whether IHOP reasonably declined to indemnify Tangas on the basis that her conduct amounted to fraud or willful misconduct. IHOP and DineEquity argued that Delaware’s business judgment rule protected their decision not to indemnify Tangas, but Tangas argued that the business judgment rule was inapplicable because the LLC agreement entitled her to indemnification. The court concluded that the business judgment rule was applicable to the issue of whether Tangas engaged in fraud or willful misconduct. Because IHOP had the power to deny indemnification in those circumstances, the court stated that Tangas was asking the court to second guess the propriety of an action that IHOP had the authority to take and that Tangas must thus show IHOP’s decision to deny indemnification was not the product of reasoned, well-informed decision making. The court concluded that the undisputed evidence established that IHOP made a reasonable decision to deny indemnification after investigating the situation and concluding that Tangas engaged in fraud “with respect to” the criminal case against Tangas. Additionally, the court concluded that IHOP and DineEquity made a reasoned business judgment not to indemnify Tangas on the ground that her refusal to participate in the interview as required by IHOP’s code of conduct was willful misconduct “with respect to” the criminal case.

*Sandt v. Energy Maint. Servs. Group I, LLC*, 534 S.W.3d 626 (Tex. App. 2017).

The court of appeals affirmed the judgment of the trial court that a Delaware LLC owed indemnity to its officer and that a settlement agreement precluded further collection of the judgment against the officer.

Jim Sandt, a former officer and member of Energy Maintenance (a Delaware LLC), sued Energy Maintenance, Timothy Nesler (the company's CEO), and other officers claiming that the defendants had committed fraud and breach of fiduciary duty by wrongfully diluting his ownership interest. While Sandt's suit was pending, the Energy Maintenance board agreed in a company resolution to indemnify Nesler for any liability arising out of or related to the Sandt litigation. The board resolution stated that the board agreed to indemnify Nesler after reviewing the Sandt litigation and discussing it with the company's officers and attorneys. The resolution also stated that the board had determined that Nesler acted in good faith and in a manner that he reasonably believed was in the company's best interest.

A jury found in favor of Sandt and against Energy Maintenance and Nesler. While an appeal was pending, the company's primary creditor took control and terminated Nesler from his position as CEO. The new board of directors then voted to revoke the prior indemnification as of the date it was purportedly granted. The rationale for the revocation was, in part, that Nesler had misrepresented to the board the facts related to the Sandt matter. After the company refused to provide indemnification, it filed suit against Nesler seeking a declaration that it did not owe him indemnity and claiming that the jury's findings of fraud and breach of fiduciary duty against him alleviated the company's indemnification obligation. Nesler counterclaimed for breach of contract.

The trial court ruled that Nesler was entitled to indemnification and that the company's failure to provide it was a breach of contract. Because a settlement agreement between the company and Sandt stated that Sandt could not recover any further, directly or indirectly, from the company, the trial court further declared that Sandt could not pursue Nesler for any amounts that the company had to indemnify. Both the company and Sandt appealed.

On appeal, the court noted that Energy Maintenance was a Delaware LLC; thus, Delaware law controlled the interpretation of the company's formation agreement. The court cited a number of Delaware law propositions, including (1) "[u]nder Delaware law, a limited liability company may indemnify any member, manager, or another 'against any and all claims and demands whatsoever,' subject to whatever standards or restrictions are included in its company agreement"; (2) "[f]or limited liability companies, Delaware law 'defers completely to the contracting parties to create and delimit rights and obligations with respect to indemnification'"; (3) "[w]hen interpreting the provisions of a limited liability company agreement, ordinary contract interpretation rules apply; the court's role is to effect the parties' intent based on the plain meaning of the agreement's terms"; and (4) "[a] court cannot rewrite or add omitted provisions in the guise of interpreting a contract."

The court noted that Article VIII of the Energy Maintenance company agreement contained provisions for indemnification and advancement of expenses. Although the provisions obligated Energy Maintenance to indemnify persons who acted in good faith, it vested the board with the authority to decide if they did act in good faith. The agreement expressly specified that an adverse judgment did not create a presumption of bad faith, and it stated a company policy of indemnifying corporate officers to the fullest extent legally possible. According to the court, "Energy Maintenance's company agreement does not, in express and affirmative terms, make members and directors ineligible for indemnification previously granted simply because a jury finds that they did not act in good faith, and we cannot rewrite its company agreement to say something it does not." In addition, the court concluded that unless Energy Maintenance had a contractual right to reconsider its decision to indemnify Nesler, it could not rescind its earlier determination. Because "[n]either its



company agreement nor the board's 2007 indemnity resolution reserved a right to revisit Nesler's right to indemnity," the court concluded that the company "could not rescind its agreement to indemnify him."

Despite the company agreement provisions that vested the board with the authority to determine whether the conditions for authorizing indemnification had been met, Energy Maintenance contended that the jury's unfavorable verdict and the judgment against Nesler for fraud disproved his good faith and thereby provided a basis for the board to revoke its earlier grant of indemnity. The company relied on Delaware decisions construing that state's corporate indemnification statute, 8 Del. Code § 145, for the proposition that a jury's finding of fraud negates good faith as a matter of public policy. The court disagreed, noting that the statutes governing Delaware corporations and Delaware limited liability companies were different. Unlike Section 145, which applied to corporations, the statute governing limited liability companies allowed indemnity "against any and all claims and demands whatsoever," subject only to the express terms of the company agreement. This statute did not purport to adopt or incorporate Delaware's public policy regarding indemnity in the corporate context, and it deferred instead to the contracting parties to place limits on indemnification.

Although the court decided that the company was obligated to indemnify Nesler from liability in the Sandt litigation, it also concluded that Sandt, in a settlement agreement, agreed to forego any collection of the judgment against Nesler for which the company would be liable. The settlement agreement provided that Sandt "will not seek to execute and will not accept recovery, in each case whether directly or indirectly, against" Energy Maintenance for any remaining liability arising from the suit. The trial court reasoned that Energy Maintenance owed indemnity to Nesler, and thus an attempt to collect the remaining money that Nesler owed under the Sandt judgment would violate the settlement agreement's clause barring Sandt from recovering any additional sum from Energy Maintenance "directly or indirectly." In light of this clause and others, the court of appeals concluded that the trial court correctly interpreted the settlement agreement: "In sum, the settlement agreement bars Sandt from recovering from Nesler because it would result in an indirect recovery from Energy Maintenance, which is obligated to indemnify Nesler for the Sandt judgment."

### **Assignment of Interest; Restrictions on Transfer**

*Succession of McCalmont*, 2018 WL 6521176, \_\_ So. 3d \_\_ (La. App. 3d Cir. 2018).

The court of appeals held that the executor of the estate of the deceased wife of a member of several LLCs was not entitled to the production of LLC business, financial, and tax records because neither the agreements nor the Louisiana LLC statute gave an assignee a right of access to the LLC's books and records.

Colleen McCalmont filed for divorce from her husband James McCalmont ("James") in August of 2016, but she passed away before the divorce was finalized or community property partitioned. One of the McCalmonts' children, Jay McCalmont ("Jay") was appointed executor of her estate. As part of the executor's duties in preparing a detailed description of property in the succession, Jay sought information from James regarding property believed to be community property. After James refused to provide this information, Jay sought to compel discovery.

The trial court granted Jay's motion to compel and ordered James to produce business, financial, and tax records of certain LLCs in which the McCalmonts had held an interest. The trial court also ordered James to comply with certain other discovery requests not involving the LLC. James appealed.

On appeal, James argued that the trial court erred in ordering the discovery of LLC documents because the operating agreement of one LLC specifically restricted assignees from inspecting records and the Louisiana Limited Liability Company statute did not entitle assignees to inspect the records of the other involved LLCs. The court cited several Louisiana law propositions, including: (1) “[a]n operating agreement, whether written or oral, governs the operations of an LLC; (2) “[i]n the absence of [an operating agreement], the default provisions of the Louisiana LLC statute govern”; (3) “[a]n operating agreement is contractual in nature; thus, it binds the members of the LLC as written and is interpreted pursuant to contract law”; (4) as to contractual interpretation, “[t]he interpretive purpose is to determine the common intent of the parties”; (5) the ordinary contract interpretation rules apply, including the interpretation of “each contractual provision in light of the other provisions in order to arrive at the meaning of the contract as a whole”; and (6) “[t]he determination of whether the words of a contract are clear and explicit or ambiguous is a question of law [and thus] an appellate court’s determination on review is whether the trial court interpreted a contract correctly or incorrectly.” Applying an abuse-of-discretion standard, the court of appeals examined the evidence in the record. As to the discovery ordered against the LLCs, the court organized its analysis around whether the operating agreements dealt with maintenance of business records and the rights of an assignee. If the operating agreements addressed these issues, the court applied the pertinent provisions of the operating agreement; if not, the court applied the Louisiana LLC statute.

First, James argued, and the court agreed, that the operating agreement of one of the LLCs at issue specifically restricted assignees of a member from inspecting company records. Section 6.1 of the the operating agreement, titled “Books and Records,” required certain records (including those at the center of this dispute) “to be maintained and to be available to ‘any Member or an assignee of an Interest.’” On the other hand, Section 8.5 provided for the rights of unadmitted assignees as follows:

A person who acquires all or any portion of an Interest but who is not admitted as a Substituted Member ... shall be entitled only to allocations and distributions with respect to such interest ... but shall have no right to any information or accounting of the affairs of the company, shall not be entitled to inspect the books or records of the company, and shall not have any of the rights of a Member.

Interpreting the language from Section 6.1 and Section 8.5 in the manner that best conformed to the objectives of the operating agreement, the court determined that the specific provision of Section 8.5 controlled over the more generally worded Section 6.1. The court reasoned that to conclude otherwise would simply eliminate the effects of Section 8.5 entirely and lead to an “absurd” reading of the operating agreement as a whole. As a result, the court concluded that Jay, as an assignee, had “no right to any information or accounting of the affairs of the company, shall not be entitled to inspect the books or records of the company, and shall not have any of the rights of a Member.” Furthermore, the court concluded that it was clear the operating agreement prohibited Jay from receiving the business, financial, and tax records that were the subject of the trial court’s discovery order. Thus, the court of appeals held that it was an abuse of discretion for the trial court to order the LLC governed by this operating agreement to produce those records and reversed the order compelling discovery.

Next, the court analyzed James’ argument that the Louisiana LLC statute, which governed the remaining LLCs whose operating agreements were silent as to the rights of assignees of membership interests, expressly restricts assignees to statutorily limited rights that do not include

the right to inspect the records of the LLC. The court began its analysis by pointing out that the Louisiana LLC statute recognizes only one form of transfer of a membership interest—an assignment—whether voluntary or involuntary. In the case of an involuntary assignment, as in the case of a member’s death, the deceased member is the assignor and the recipient of the transferred interest, such as the executor or other legal representative, is treated strictly as the assignee. The court explained that an assignment results in a bifurcation of membership rights: the financial rights vest with the assignee, while the management rights remain vested with the assignor, even if deceased, until the assignee is admitted as a member. Thus, the statute confers on the assignee only the limited right to receive those distributions and allocations of profits, losses, and tax items that the assignor would otherwise have been entitled to receive. The court of appeals then relied on its decision in a 2004 case for the proposition that an assignee “is not entitled to inspect [the LLC’s] records, since this action is reserved for the members of the LLC.” The court acknowledged that “the law as written allows for the creation of situations whereby an assignee of a deceased member’s rights, while due distributions, may never be able to see company records to ensure he is actually receiving those distributions in full, because remaining members can simply withhold records that would show what, if anything, may be owed.” However, the court concluded that Louisiana LLC law clearly limited Jay’s rights as an assignee and compelled the court to hold that it was an abuse of discretion for the trial court to order the LLCs to produce the requested records. Thus, the court reversed the trial court’s order compelling discovery.

*Nicolazzi v. Bone*, 564 S.W.3d 364 (Mo. Ct. App. 2018).

In a dispute regarding a member’s breach of an LLC operating agreement and alleged withdrawal from the company, the court of appeals concluded that the trial court erroneously applied the law in finding that the member breached the operating agreement by discussing the sale of his interest with a third party without the consent of the other member.

Peter Nicolazzi and Laura Bone formed Young in Spirit Adult Day Care, LLC (the “LLC”), an adult daycare business, in 2005. Immediately following its formation, Nicolazzi and Bone were the LLC’s only workers and, under the operating agreement they signed in 2005, the only members. Nicolazzi was responsible for performing service-related tasks for the LLC’s customers and Bone primarily performed managerial and nursing duties. When business expanded, Bone’s duties grew while Nicolazzi’s tasks were handled by employees that the company hired. As time went on, the parties’ business relationship deteriorated. In 2011, Nicolazzi did not seek Bone’s permission before he approached a competitor about buying his interest in the LLC. On April 30, 2011, Nicolazzi effectively stopped participating in the operation of the LLC, while Bone continued to operate the LLC. In June of 2011, Bone filed articles of incorporation for “Young in Spring Adult Day Center, Inc.” and, on the next day, notified Nicolazzi that the business would continue in this new entity and that she would be dissolving the LLC.

On June 30, 2011, Nicolazzi filed his petition against Bone and requested various forms of relief. Among her counterclaims, Bone asked the trial court to find that Nicolazzi was no longer a member of the LLC because he breached the operating agreement by failing to make his required capital contribution and by soliciting purchase of his membership interest by a third party without her consent. After a bench trial, the trial court entered judgment in favor of Bone and against Nicolazzi, finding that Nicolazzi breached the LLC’s operating agreement by failing to make the required capital contribution and by soliciting purchase of his membership interest without Bone’s consent, and that his actions constituted “events of withdrawal” under the Missouri Limited Liability Company Act (the “Missouri LLC Act”). The trial court concluded that Nicolazzi was no longer a member of the LLC, that Bone was the sole member and owner of the LLC, and that Nicolazzi had

been paid all salary and distributions the LLC owed to him. After Nicolazzi's motion for a new trial and amendment of the judgment was denied, he appealed.

Because Nicolazzi's arguments on appeal depended upon the application of the LLC's operating agreement and the Missouri LLC Act, the court cited a number of Missouri law propositions, including: (1) "[w]hile limited liability companies are creatures of statute, [the court] 'interpret[s] an L.L.C.'s operating agreement according to the ordinary rules of contract law"; (2) "[t]he primary rule of contract interpretation is to determine the intent of the parties and to give effect to that intent"; (3) "[i]n interpreting an operating agreement, [the court] applie[s] the plain and ordinary meaning of the words in the agreement and consider[s] the document as a whole"; and (4) "[w]here a contract's terms are clear and unambiguous, [the court will] enforce the agreement as written and will not supply additional terms." The court also cited the Missouri LLC Act for the requirement that member(s) adopt an operating agreement and the statutory definition of "member" as "any person that signs in person . . . or otherwise is a party to the operating agreement at the time the [LLC] is formed and is identified as a member in that operating agreement. . . ." The court reasoned that because Nicolazzi was named in the LLC's operating agreement, he signed the operating agreement when the LLC was formed, and the operating agreement did not establish any further condition or prerequisites to membership, then he was a member from that point forward. The court of appeals further concluded that Nicolazzi and Bone were the only members of the LLC throughout the company's existence.

The standard of review in this case required the court of appeals to affirm the trial court's judgment unless there was no substantial evidence to support it, it was against the weight of the evidence, or it erroneously declared or applied the law. The court organized its discussion around two primary issues: first, whether Nicolazzi breached the LLC's operating agreement; and second, whether Nicolazzi's actions constituted withdrawal from the LLC, leaving Bone as the sole member.

The first issue that the court of appeals addressed was whether the trial court erred in finding that Nicolazzi breached the LLC's operating agreement. After concluding that the trial court did not err in finding that Nicolazzi breached the operating agreement by failing to making his required initial capital contribution, the court of appeals turned to Nicolazzi's argument that the trial court misapplied the law in concluding that his attempt "to sell his interest in the business to a third party without [Bone's] written consent" constituted a breach of the operating agreement. Paragraph 7 of the LLC's operating agreement stated that "[n]either of the Members shall, without the written consent of the other Member, sell, assign, pledge, mortgage, or otherwise transfer [his] [her] interest in the LLC." However, the court observed that neither the operating agreement nor the Missouri LLC Act defined these prohibited actions. At trial, it was established that Nicolazzi did discuss a sale of his interest in the LLC with a third party without seeking Bone's permission, though Nicolazzi testified the discussion was to gauge how interested this buyer was in the potential sale. The court found that a plain reading of Paragraph 7 would prohibit the parties from the listed actions without the other member's written consent. However, the court distinguished between a *conveyance* and a *solicitation* and noted that the language of Paragraph 7 indicated that the parties intended to prohibit one another from conveying their membership interest without the other member's permission. On the other hand, neither Paragraph 7 nor any other provision of the operating agreement prohibited (or even addressed) a member's attempt to sell or to discuss a sale of his or her interest. The court observed that it was undisputed that Nicolazzi did not ever actually perform any of the actions listed in Paragraph 7, and Bone argued before the trial court that Nicolazzi breached the operating agreement by soliciting the purchase of his membership interest. The court concluded that the operating agreement did not necessitate that a member receive the other member's consent before soliciting purchase of the member's interest by a prospective buyer. Because the operating agreement

lacked such language, the court of appeals found that the trial court's conclusion that Nicolazzi breached the operating agreement by attempting to sell his membership interest to a third party without Bone's written consent was an erroneous application of the law. Therefore, the court reversed the trial court's judgment on this issue.

*Abdullatif v. Choudhri*, 561 S.W.3d 590 (Tex. App. 2018).

In a dispute regarding the ownership of a limited partnership and its general partner, the court of appeals concluded that: (1) the trial court erred in submitting a jury question inquiring whether the parties to written assignments of interests in the limited partnership and its LLC general partner agreed to an alleged oral condition because the alleged condition contradicted the unambiguous terms of the assignments and was thus precluded by the parol evidence rule; (2) the language of certain assignments did not transfer any interest in the LLC general partner of the limited partnership; (3) certain purported transfers of interest in the LLC general partner were null and void ab initio because they were prohibited under the company agreement, and subsequent consent or ratification could not operate to give life to an attempted transfer that was null and void; (4) certain purported transfers of interests in the limited partnership were valid even if the transfers were prohibited by the partnership agreement because the partnership agreement allowed the general partner to recognize a transfer that would otherwise be null and void under the terms of the agreement.

Osama Abdullatif ("Latif") and Ali Mokaram entered into a real estate investment venture by forming Mokaram Latif West Loop, L.P. ("ML Partnership") in which Mokaram and Latif were each 49.5% limited partners and Mokaram-Latif General, LLC ("ML General") was the 1% general partner. Mokaram and Latif were the managers and equal members of ML General. Mokaram and Ali Choudhri became friends and engaged in business transactions together, including transactions in 2008 and 2010 involving ML Partnership and ML General.

The 2008 transaction included an agreement in which Mokaram purported to transfer to Choudhri a limited partnership interest in ML Partnership, and the 2010 transaction included purported assignments by Mokaram to Choudhri of interests in ML Partnership and ML General. Disputes regarding these transactions arose, and eventually Latif purchased all of Mokaram's interests in ML Partnership and ML General along with all of Mokaram's claims against Choudhri relating to interests in the entities. Mokaram agreed to continue to pursue his claims against Choudhri in this lawsuit in which Mokaram, Latif, Choudhri, and ML Partnership were parties. The trial court entered a declaratory judgment regarding the ownership of the entities, and Mokaram and Latif appealed.

The first issue the court of appeals addressed was whether the trial court erred in submitting a jury question inquiring whether Mokaram and Choudhri agreed that the 2010 assignment was not effective and that Mokaram would return the money paid by Choudhri to Mokaram. Because the unambiguous language of the assignment provided that it was effective immediately and did not indicate that it was contingent on any condition, the court of appeals concluded that the testimony regarding an alleged oral condition was precluded by the parol-evidence rule from contradicting the unambiguous language of the assignment. Thus, the trial court should not have submitted any question inquiring into the enforceability of the oral condition. The court stated that the parol-evidence rule would not have precluded the trial court from submitting a question about an alleged subsequent agreement to rescind, but the jury question that was submitted did not ask about a subsequent agreement to rescind. The court also stated that the evidence did not raise a genuine fact issue as to whether Mokaram and Choudhri agreed to rescind the assignment after they executed it.

The court next addressed the argument that the trial court lacked jurisdiction over the declaratory judgment claims regarding Choudhri's ownership and management rights in ML General because ML General was not a party. The court of appeals held that the trial court did not lack jurisdiction over the claims. Although the declaratory judgment did not bind ML General, it was binding on the parties in this action.

Next the court of appeals discussed whether the trial court erred in declaring that Choudhri had owned an interest in ML General since the date of the 2008 assignment. Based on the language of the documents executed in 2008, which purported to transfer to Choudhri an interest in ML Partnership and certain real property, the court concluded that Mokaram did not purport to transfer any interest in ML General. The documents indicated that Mokaram and Choudhri thought that ML Partnership owned the real property referred to in the assignments and that they intended to transfer an indirect interest in the real property by transferring an interest in ML Partnership. However, assuming that ML Partnership owned the real property referred to in the assignments, that would not mean that ML General had any ownership in the property, and the court concluded that the evidence did not show that Mokaram transferred any interest in ML General to Choudhri by virtue of the 2008 assignments.

The 2010 assignments purported to transfer from Mokaram to Choudhri interests in both ML General and ML Partnership. Both the company agreement of ML General and the partnership agreement of ML Partnership contained restrictions on transfer, and the court discussed the effect of the purported transfers by Mokaram.

The ML General company agreement prohibited a member from transferring any of its membership interest except in limited circumstances, such as with the approval of members having more than 66.67% of the interests of all members. The company agreement stated that a transfer in violation of its provisions was "null and void ab initio." Assuming Mokaram's execution of the assignments represented his approval of the transfers, there was no evidence that Latif, the other 50% member at the time, approved the assignments before Mokaram purported to assign his interest, and there was no evidence that any of the other circumstances under which a transfer was permitted were present. Choudhri relied on a 2011 consent signed by Latif as manager and member of ML General in which Latif consented to any prior transfers by Mokaram to Choudhri of a membership interest in ML General. The court concluded that the purported assignments were null and void from the outset under the unambiguous language of the company agreement, and as such the purported transfers could not be ratified or validated after the fact. Thus, the trial court erred in declaring that Choudhri had owned 50% of ML General and had been a manager of ML General from and after the 2010 assignments.

The ML Partnership agreement also contained prohibitions on transfer, and the court next addressed the effect of purported assignments in 2010 by Mokaram to Choudhri of a limited partnership interest in ML Partnership. Section 10.1 of the partnership agreement prohibited a limited partner from transferring all or any portion of the limited partner's interest without the prior written consent of the general partner. Section 10.2 of the partnership agreement contained a right-of-first-refusal provision in favor of the other partners in the event a limited partner received a bona fide offer to purchase all or any portion of the limited partner's interest. Section 10.3 provided for certain "Permitted Transfers" (to a trust for the benefit of the limited partner, the guardian or estate of a limited partner, or a person approved by all the partners) notwithstanding the consent otherwise required by Section 10.1. Section 10.6 provided that a transfer that was not permitted under the partnership agreement "shall be null and void and of no effect whatever; provided that if the Partnership is required to recognize a Transfer that is not permitted (or if the Partnership, in its sole discretion, elects to recognize a Transfer that is not permitted)," the transferred interest was limited

to the transferor's rights to allocations and distributions. Finally, Section 10.10 provided that the partnership was not required to recognize the interest of any transferee who obtained a purported transferred interest pursuant to a transfer that was not authorized by the partnership agreement, and such a transfer was "null and void for all purposes."

The court stated that the plain meaning of "null and void and of no effect whatever" would preclude a transfer that was not permitted by the partnership agreement from being subject to ratification, confirmation, or waiver, but the court concluded that the phrase "null and void and of no effect whatever" was not used in its ordinary sense given that the agreement unambiguously provided that the partnership could elect to recognize a transfer that was not permitted and thus was or would have been "null and void and of no effect whatever." The court noted the difference between the ML General company agreement (which the court had held did not permit ratification of a null and void transfer) and the ML Partnership agreement and concluded that the two agreements were separate and independent agreements that should not be construed together as one. Further, assuming the agreements should be construed as a single contract, the provisions unambiguously allowed the recognition of an otherwise void transfer of a partnership interest but did not allow the recognition of a void transfer of a membership interest.

Because Mokaram signed the assignment of his interests to Choudhri not only as assignor, but in his capacity as manager of ML General, the general partner of ML Partnership, under a legend stating that the transfer was consented to by the general partner, the court concluded that ML Partnership recognized the transfer of the interests. Relying on the language of the ML General company agreement (which provided that the managers shall have the sole and exclusive control of the management of ML General and shall make all decisions not otherwise provided for in the company agreement) and Section 101.254 of the Business Organizations Code (which provides that each governing person is an agent of the LLC for the purpose of its business), the court stated that Mokaram's signature as manager was binding on ML General, and ML Partnership thus recognized the transfer as valid and effective as provided by Section 10.6 of the partnership agreement. The court concluded that an earlier purported transfer in 2008 by Mokaram to Choudhri of a limited partnership interest was not effective because there was no evidence that the transfer was permitted under any of the provisions of the partnership agreement nor was there any evidence that the partnership was required to recognize the transfer or exercised its discretion to recognize the transfer.

Finally, the court concluded that the trial court did not err in refusing to clarify what rights Choudhri had as a result of his ownership of an interest in ML Partnership. The trial court declared that Choudhri owned 49.5% of ML Partnership from and after the 2010 assignments and that he had "all beneficial rights and interests" that flowed from his ownership of an interest in ML Partnership. The court stated that the interests transferred to Choudhri were limited to rights to allocations and distributions under the unambiguous language of Section 10.6 of the partnership agreement, and neither Section 10.2 nor 10.6 gave Choudhri the right to become a limited partner under the assignments. The trial court did not declare that Choudhri was a limited partner, and although the "beneficial rights and interests" were significantly limited by the agreement, the trial court did not inaccurately characterize them. Thus, the court of appeals concluded that the trial court did not err in making the declaration and in refusing to clarify it.

### **Withdrawal of Member**

*Nicolazzi v. Bone*, 564 S.W.3d 364 (Mo. Ct. App. 2018).

In a dispute regarding a member's breach of an LLC operating agreement and alleged withdrawal from the company, the court of appeals concluded that: (1) the trial court did not err in

finding that the member breached the operating agreement by failing to make his required initial capital contribution; (2) the trial court erroneously applied the law in finding that the member breached the operating agreement by discussing the sale of his interest with a third party without the consent of the other member; (3) the trial court erroneously applied the law in finding that the member's actions prior to filing his petition constituted withdrawal from the LLC; (4) the trial court erred in determining that the other member was the sole member of the LLC; and (5) the member's filing of his petition may have constituted an "event of withdrawal" as a matter of law.

Peter Nicolazzi and Laura Bone formed Young in Spirit Adult Day Care, LLC (the "LLC"), an adult daycare business, in 2005. Immediately following its formation, Nicolazzi and Bone were the LLC's only workers and, under the operating agreement they signed in 2005, the only members. Nicolazzi was responsible for performing service-related tasks for the LLC's customers and Bone primarily performed managerial and nursing duties. When business expanded, Bone's duties grew while Nicolazzi's tasks were handled by employees that the company hired. As time went on, the parties' business relationship deteriorated. In 2011, Nicolazzi did not seek Bone's permission before he approached a competitor about buying his interest in the LLC. On April 30, 2011, Nicolazzi effectively stopped participating in the operation of the LLC, while Bone continued to operate the LLC. In June of 2011, Bone filed articles of incorporation for "Young in Spring Adult Day Center, Inc." and, on the next day, notified Nicolazzi that the business would continue in this new entity and that she would be dissolving the LLC.

On June 30, 2011, Nicolazzi filed his petition against Bone and requested: (1) a declaratory judgment determining whether Bone was still a member and whether she had misappropriated LLC funds, and ordering Bone to reimburse Nicolazzi for distributions received in excess of her fifty percent share; (2) a complete accounting from Bone of the LLC and the new business entity; and (3) judgment for the losses, expenses, and damages that Bone owed to Nicolazzi for his interest in the LLC. Among her counterclaims, Bone asked the trial court to find that Nicolazzi was no longer a member of the LLC because he breached the operating agreement by failing to make his required capital contribution and by soliciting purchase of his membership interest by a third party without her consent. After a bench trial, the trial court entered judgment in favor of Bone and against Nicolazzi, finding that Nicolazzi breached the LLC's operating agreement by failing to make the required capital contribution and by soliciting purchase of his membership interest without Bone's consent, and that his actions constituted "events of withdrawal" under the Missouri Limited Liability Company Act (the "Missouri LLC Act"). The trial court concluded that Nicolazzi was no longer a member of the LLC, that Bone was the sole member and owner of the LLC, and that Nicolazzi had been paid all salary and distributions the LLC owed to him. After Nicolazzi's motion for a new trial and amendment of the judgment was denied, he appealed.

Because Nicolazzi's arguments on appeal depended upon the application of the LLC's operating agreement and the Missouri LLC Act, the court cited a number of Missouri law propositions, including: (1) "[w]hile limited liability companies are creatures of statute, [the court] 'interpret[s] an L.L.C.'s operating agreement according to the ordinary rules of contract law"; (2) "[t]he primary rule of contract interpretation is to determine the intent of the parties and to give effect to that intent"; (3) "[i]n interpreting an operating agreement, [the court] applie[s] the plain and ordinary meaning of the words in the agreement and consider[s] the document as a whole"; and (4) "[w]here a contract's terms are clear and unambiguous, [the court will] enforce the agreement as written and will not supply additional terms." The court also cited the Missouri LLC Act for the requirement that member(s) adopt an operating agreement and the statutory definition of "member" as "any person that signs in person . . . or otherwise is a party to the operating agreement at the time the [LLC] is formed and is identified as a member in that operating agreement..." The court



reasoned that because Nicolazzi was named in the LLC's operating agreement, he signed the operating agreement when the LLC was formed, and the operating agreement did not establish any further condition or prerequisites to membership, then he was a member from that point forward. The court of appeals further concluded that Nicolazzi and Bone were the only members of the LLC throughout the company's existence.

The standard of review in this case required the court of appeals to affirm the trial court's judgment unless there was no substantial evidence to support it, it was against the weight of the evidence, or it erroneously declared or applied the law. The court organized its discussion around two primary issues: first, whether Nicolazzi breached the LLC's operating agreement; and second, whether Nicolazzi's actions constituted withdrawal from the LLC, leaving Bone as the sole member.

The first issue that the court of appeals addressed was whether the trial court erred in finding that Nicolazzi breached the LLC's operating agreement. Nicolazzi argued that the trial court's conclusion that he breached the operating agreement by failing to make his initial capital contribution was against the weight of the evidence. The LLC's operating agreement contained a provision requiring Nicolazzi and Bone to contribute capital in equal amounts, including "initial contributions" of \$50,000 each. However, no deadline was stated in the operating agreement and neither party testified that a due date had been agreed to otherwise. At trial, the parties presented "staggeringly" different amounts when providing evidence of Nicolazzi's cash and non-cash capital contributions during the five years between the LLC's formation and when he filed his petition: Bone and the LLC's CPA testified that he had contributed \$31,065, while Nicolazzi and his retained expert witness (who was also a CPA) testified that he had contributed \$79,271. In its judgment, the trial court justified its determination that the testimony on Bone's side was more credible and reliable by recognizing "inconsistencies and shortcomings" in Nicolazzi's purported contributions and that his expert's opinion was based on those facts. The trial court even noted that "[i]t was difficult at best, impossible at worst, to sort out [Nicolazzi's] personal finances from company business." Because the court's deference to the trial court's findings of facts in this case extended to credibility determinations of witnesses, the court of appeals held that the trial court's conclusion that Nicolazzi breached the LLC's operating agreement by failing to make his required initial capital contribution requirement was not against the weight of the evidence. The court of appeals noted that it was not necessary to analyze the meaning of the word "initial" in relation to the required capital contributions, despite the absence of a deadline in the operating agreement, because it was established at trial that both parties intended and understood the \$50,000 would be paid within six months of the execution of the LLC's operating agreement. The court further noted that under any definition of "initial," Nicolazzi's failure to make the required initial capital contribution within a five-year time span undoubtedly constituted a breach of the operating agreement. Therefore, the court of appeals affirmed the trial court's judgment in this regard.

Nicolazzi next argued that the trial court's conclusion that his attempt "to sell his interest in the business to a third party without [Bone's] written consent" constituted a breach of the operating agreement was a misapplication of law. Paragraph 7 of the LLC's operating agreement stated that "[n]either of the Members shall, without the written consent of the other Member, sell, assign, pledge, mortgage, or otherwise transfer [his] [her] interest in the LLC." However, the court observed that neither the operating agreement nor the Missouri LLC Act defined these prohibited actions. At trial, it was established that Nicolazzi did discuss a sale of his interest in the LLC with a third party without seeking Bone's permission, though Nicolazzi testified the discussion was to gauge how interested this buyer was in the potential sale. The court found that a plain reading of Paragraph 7 would prohibit the parties from the listed actions without the other member's written consent. However, the court distinguished between a *conveyance* and a *solicitation* and noted that the

language of Paragraph 7 indicated that the parties intended to prohibit one another from conveying their membership interest without the other member's permission. On the other hand, neither Paragraph 7 nor any other provision of the operating agreement prohibited (or even addressed) a member's attempt to sell or to discuss a sale of his or her interest. The court observed that it was undisputed that Nicolazzi did not ever actually perform any of the actions listed in Paragraph 7, and Bone argued before the trial court that Nicolazzi breached the operating agreement by soliciting the purchase of his membership interest. The court concluded that the operating agreement did not necessitate that a member receive the other member's consent before soliciting purchase of the member's interest by a prospective buyer. Because the operating agreement lacked such language, the court of appeals found that the trial court's conclusion that Nicolazzi breached the operating agreement by attempting to sell his membership interest to a third party without Bone's written consent was an erroneous application of the law. Therefore, the court reversed the trial courts judgment on this issue.

The second issue that the court of appeals addressed was whether the trial court erred in finding that Nicolazzi's actions constituted an "event of withdrawal" under the Missouri LLC Act and finding that Bone was the LLC's sole member. Nicolazzi argued that the trial court's conclusion that he withdrew was a misapplication of the Missouri LLC Act. The court of appeals observed that the trial court relied on two provisions of the Missouri LLC Act when it concluded that Nicolazzi's actions of failing to make his required initial capital contributions, attempting to sell his membership interest, and leaving the LLC in April of 2011 constituted "events of withdrawal." The Missouri LLC Act permits a member to withdraw from a LLC as specified in writing in the operating agreement, at any time upon giving ninety-days' prior written notice to the other members, or under certain conditions (e.g., assignment of a member's entire interest in the LLC or expulsion as a member in accordance with the operating agreement). Because the LLC's operating agreement was silent on what would constitute an event of withdrawal, Nicolazzi did not give any written notice to Bone, and the other statutory conditions were not present before Nicolazzi filed his petition, the court of appeals concluded that the trial court erroneously applied the two provisions of the Missouri LLC Act in finding that Nicolazzi's actions constituted "events of withdrawal" from the LLC. The court pointed out that while it did affirm the trial court's finding that Nicolazzi breached the operating agreement by failing to make his initial capital contribution, that breach did not equate to his withdrawal under the operating agreement or the Missouri LLC Act. As a result, the court of appeals reversed the trial court's judgment in that regard.

The court further concluded that Nicolazzi was still a member of the LLC at the time he filed his petition because he was a member when the LLC was formed and did not withdraw before filing. Therefore, the court of appeals reversed the trial court's determination that Bone was the sole member of the LLC. However, the court also found that, as a matter of law, Nicolazzi may have withdrawn from the LLC by actually filing his petition. Under the Missouri LLC Act, an "event of withdrawal" includes a member filing a petition "[s]eeking for himself any reorganization, arrangement, composition, readjustment, liquidation, or similar relief under any statute, law, or regulation ...." Because this issue was not before the trial court, the court of appeals remanded the case to that court with instructions to determine whether Nicolazzi's filing of his petition constituted an event of withdrawal. The court of appeals also found that the LLC's operating agreement did not state the amount or method for determining the distribution to be paid to a withdrawing member. Thus, if the trial court determined that Nicolazzi's filing of his petition constituted such an "event of withdrawal," then the court of appeals instructed the trial court to determine the "fair value" of Nicolazzi's interest in the LLC as of the date of withdrawal (the date that he filed his petition).

In sum, the court of appeals held that the trial court's conclusion that Nicolazzi breached the LLC's operating agreement by failing to make his required initial capital contribution was not against the weight of the evidence and affirmed the trial court's judgment in that regard. The court of appeals also held that the trial court erroneously applied the law in finding that Nicolazzi breached the LLC's operating agreement by discussing the sale of his interest with a third party without Bone's consent and in finding that Nicolazzi withdrew from the LLC prior to the filing of his petition, reversing the trial court's judgment on these issues. Because the court of appeals found that Nicolazzi did not withdraw from the LLC prior to the filing of his petition, the court also found that the trial court erred in determining that Bone was the sole member of the LLC and reversed the trial court's judgment in that regard. Finally, as a matter of law, the court of appeals found that Nicolazzi's actual filing of his petition may itself have constituted an "event of withdrawal." Because this issue was not before the trial court, the court of appeals remanded the case to the trial court to determine if Nicolazzi withdrew pursuant to the Missouri LLC Act, and if he did, to determine the "fair value" of his interest in the LLC at the time of withdrawal.

### **Derivative Suits**

*Moss v. Princip*, 913 F.3d 508 (5th Cir. 2019).

The court affirmed the trial court's dismissal of a nondiverse partnership in a suit brought by two partners alleging claims against the other two partners for fraud, breach of fiduciary duty, breach of partnership agreement, conversion, and money had and received. The court concluded that the partnership was dispensable because all partners were party to the suit and the partnership's interests in the suit were adequately represented by the partners. Further, any risk of duplicative litigation brought by the partnership itself could be prevented by injunctive relief. The court applied the same reasoning to an LLC formed by one of the plaintiffs and one of the defendants.

The plaintiffs, separately, formed partnerships with defendant Marko Princip, whereby each plaintiff received 30% ownership in the partnership. The plaintiffs filed suit against Princip and another partner, Martin, alleging that the parties had created a partnership and that the defendants were liable for common-law fraud, breach of fiduciary duty, breach of the partnership agreement, conversion, and money had and received. The defendants removed the case to federal court from a Texas state court on the basis of diversity jurisdiction. A jury determined that a partnership existed among the parties, and the defendants moved to dismiss the claim for lack of subject-matter jurisdiction just before the entry of final judgment. The defendants argued that there was incomplete diversity due to the presence of the partnership. The plaintiffs moved to dismiss the partnership as a dispensable nondiverse party. The trial court granted the plaintiffs' motion, restoring complete diversity, and the defendants appealed.

The court of appeals first recognized that for purposes of diversity jurisdiction, a partnership is a citizen of every state in which one of its partners is a citizen. Ordinarily, diversity jurisdiction must exist at the time of removal. However, courts may dismiss nondiverse parties under Rule 21, "even after judgment has been rendered." Under Rule 19, a court can dismiss a required party who would destroy diversity, if the court determines the party is dispensable. When making this determination regarding "whether, in equity and good conscience, the action should proceed among the existing parties," the court will consider four factors. These four factors include: (1) the extent to which a judgment rendered in the person's absence might prejudice that person or the existing parties; (2) the extent to which any prejudice could be lessened or avoided by protective provisions in the judgment, shaping the relief, or other measures; (3) whether a judgment rendered in the person's absence would be adequate; and (4) whether the plaintiff would have an adequate remedy

if the action were dismissed for nonjoinder. As the court noted, this analysis requires a case-by-case approach.

The court noted two previous decisions of the Fifth Circuit Court of Appeals in which the court found the partnership indispensable when the claims were derivative of the partnership's interests. However, recognizing Rule 19 as a flexible and pragmatic approach, the court distinguished the two prior decisions on the basis that they involved "threatened prejudice to the partnership if the case proceeded in its absence." Further, in neither of the two cases were all constituent partners of the partnership parties to the suit. The court looked instead to decisions by sister courts in which the courts found a partnership's interest was adequately represented when all partners, or all general partners, were parties to the suit. While the court suggested the trial court could consider the tactical advantage of the partnership's presence, no such advantages were present in this case, where the partnership's role was purely passive throughout the litigation. The court acknowledged that a partnership is legally treated as a separate entity, but the court stated that "[a] partnership's interests as an entity consist of an aggregation of those interests of each of the individual partners that are relevant to the purpose of the partnership."

The court next addressed the defendants' assertion that the partnership was required to be joined as a "real party in interest" under Rule 17(a). The court pointed out that the Texas partnership statute provides for liability of a partner to a partnership or its partners for breach of the partnership agreement or violation of duties. The court commented in a footnote that some Texas courts have construed the statute to restrict partners' ability to sue for actions that have diminished the value of the partnership, but the court pointed out that these cases only address limited partnerships, and the court cited other cases indicating that the logic of these limited partnership cases is not universally accepted. The court stated that it could not conclude that the partnership was required to be joined as a plaintiff here because any interest of the partnership was fully represented and vindicated and there was no need to preserve partnership assets for all partners' benefit. The court reiterated that the partnership was a proper party but was not indispensable since its interest was fully represented by the presence of all partners. The court further explained that "the fact that an absent person could bring the action as a real party in interest does not of itself make that person a necessary or indispensable party." Although Rule 17 insures that a judgment will generally have proper effect as *res judicata* and protect a defendant from the risk of subsequent litigation, the court stated that any risk of duplicative litigation could be alleviated through properly tailored protective provisions in the judgment (such as injunctive relief prohibiting the plaintiffs from suing the defendants on behalf of the partnership on claims the partnership could have raised in the suit and ordering the plaintiffs to cause the partnership to release the claims as a condition of judgment).

The defendants also raised essentially the same challenges based on the presence of an LLC formed by one of the plaintiffs and one of the defendants. The court stated that the defendants did not argue that the LLC should be treated differently from the partnership, and the court stated that its analysis extended to the LLC, which was also dismissed by the district court.

In sum, the court concluded that the partnership and LLC were not indispensable parties, and the court remanded the case in order for the district court to consider appropriate injunctive relief to guard against any risk of duplicative litigation.

***Davis v. MKR Dev., LLC***, 814 S.E.2d 179 (Va. 2018).

The Virginia Supreme Court held that amendments to the provisions of the Virginia LLC statute on derivative suits in 2011 did not abolish the futility exception to the demand requirement.

Before it was amended in 2011, § 13.1-1042 of the Virginia Code authorized a member to bring a derivative action on behalf of the LLC "if members or managers with authority to do so have

refused the action or if an effort to cause those members or managers to bring the action is not likely to succeed.” This language effectively codified, in the LLC context, Virginia case law in the corporate context requiring demand on the board of directors subject to a futility exception. As amended, § 13.1-1042 imposes a written demand requirement and 90-day waiting period before a member may file a derivative suit on behalf of the LLC, and § 13.1-1042 makes no mention of any futility exception. However, § 13.1-1044, which sets forth pleading requirements for a member derivative suit, requires the complaint to “set forth with particularity the effort of the plaintiff to secure commencement of the action by a member or manager with the authority to do so *or the reasons for not making the effort.*” (Emphasis added.) The court observed that this language would be superfluous absent a futility exception. In addition, the court pointed out that § 13.1-1001(A) provides that “the principles of law and equity supplement” the LLC statute except where displaced by particular provisions of the statute. Because derivative actions, including the futility exception, “developed on the equity side of the court” and are thus “principles of equity,” the court concluded that the 2011 amendment “had the effect of replacing an express textual reference in Code § 13.1-1042 with an incorporation by reference of a rule drawn by case law.” In sum, the court held that the General Assembly did not abolish the futility exception when it amended § 13.1-1042 in 2011.

*In re LoneStar Logo & Signs, LLC*, 552 S.W.3d 342 (Tex. App. 2018).

The court of appeals held that the trial court abused its discretion in holding that a former member of a closely held LLC had standing to pursue derivative claims. The court rejected the former member’s argument that the Legislature in Subchapter J of Chapter 101 of the Texas Business Organizations Code intended to eliminate any requirement of present member status with respect to a “derivative proceeding” on behalf of a closely held LLC.

Dunster Live, LLC (“Dunster”), the plaintiff in the action underlying this mandamus action, sued individually and derivatively complaining that the defendant members of LoneStar Logo & Signs, LLC (“LoneStar 1”) acted wrongfully in forming a new LLC, which did not include the plaintiff as a member, to perform a new contract that essentially continued the business in which LoneStar 1 was previously engaged. The defendants acknowledged that the majority owners of LoneStar 1 deliberately sought to exclude Dunster from their dealings relating to the new contract but maintained that they possessed the legal right and good reason to do so. The immediate focus of this mandamus proceeding was the threshold question of Dunster’s standing to pursue its derivative claims.

The defendants in the underlying proceeding sought summary judgment on the basis that Dunster’s interest in LoneStar 1 had been redeemed due to failure to pay a capital call before Dunster filed its lawsuit and that Dunster thus did not have standing to pursue its derivative claims. Dunster disputed the effectiveness of the redemption based on the terms of the company agreement and alleged breaches of fiduciary duty and lack of a valid business purpose, but the trial court ruled that Dunster’s membership interest in LoneStar 1 was validly redeemed and that Dunster ceased being a member of LoneStar 1 before the lawsuit was filed. The trial court declined to dismiss Dunster’s derivative claims, however, concluding that Dunster had standing because Dunster was a member at the time its derivative claims accrued.

The court of appeals began its analysis by noting that “the legal principles governing derivative claims brought on behalf of LLCs are, at least with respect to this case, materially identical extensions or analogues of those that have developed in regard to shareholder-derivative actions on behalf of corporations.” The court reviewed the historical roots, purposes, and requirements of a derivative action, including “the rule, recognized in Texas as elsewhere, that a corporate shareholder (and, by logical extension, an LLC member) must have and maintain that ownership status in order

to have standing to prosecute derivative claims on the entity’s behalf.” The court acknowledged that “Texas courts have recognized an equitable exception to this ownership requirement where a shareholder’s interest is ‘destroyed’ involuntarily without a valid business purpose,” but the court stated that “the district court has determined that this exception is not applicable here by granting partial summary judgment recognizing that the redemption had been effective in causing Dunster to ‘cease[ ] being a member of LoneStar Logo & Signs, LLC . . . .’”

The court generally reviewed the matters covered by Subchapter J of Chapter 101 of the Texas Business Organizations Code (Sections 101.451 through 101.463), which addresses derivative proceedings in the LLC context and parallels the statutes governing derivative proceedings involving for-profit corporations in Subchapter L of Chapter 21 of the Texas Business Organizations Code. The court called attention to the standing requirements of Section 101.452, which include the so-called “contemporaneous ownership” requirement. Section 101.463, however, contains provisions specifically applicable to LoneStar 1 as a “closely held LLC” (an LLC with fewer than 35 members and no membership interests listed on a national securities exchange or regularly quoted in an over-the-counter market). Section 101.463 provides that Sections 101.452-101.459 do not apply to closely held LLCs. The court explained that the Texas Supreme Court has determined that the analogous provisions in the corporate context codified a version of the shareholder-derivative action that permits a shareholder of a closely held corporation to bring an action on behalf of the corporation free of the statutory standing, demand, and mandatory-dismissal requirements that would otherwise apply.

The court explained that “[t]he gravamen of Dunster’s standing theory is that Sections 101.463 and 101.451, as the Texas Supreme Court has construed this same language in regard to shareholder-derivative suits, codifies a version of the derivative action that also eliminates any requirement that a claimant presently possess member status in order to assert derivative claims on behalf of a closely held LLC.” Dunster argued that it satisfied the contemporaneous-ownership requirement in Section 101.452 because it still had member status when the derivative claims accrued, and the district court relied on this rationale in denying summary judgment on the standing issue. Dunster’s arguments rested upon the premise that the Legislature in Subchapter J intended to eliminate any requirement of present member status from the “derivative proceeding” it codified, but the court of appeals concluded that “[t]he statutory language does not go that far, nor has the Texas Supreme Court so held.”

In explaining its rejection of Dunster’s standing theory, the court of appeals initially observed that the implications of Dunster’s theory should give some pause in that its theory seemed to imply that a litigant need not meet standing requirements of any kind in order to bring a derivative suit on behalf of a closely held LLC. The court rejected Dunster’s argument that the import of Section 101.463’s provision allowing a court to treat a derivative action brought by a member of a closely held LLC as a direct action for the member’s own benefit is that a plaintiff’s standing to bring a derivative claim is contingent on its standing to bring a direct claim. The court pointed out that the Texas Supreme Court has held that “the proceeding still must be derivative” under the parallel language governing closely held corporations, and the court of appeals presumed that the Legislature codified its statutory versions of “derivative actions” with awareness that a fundamental feature of such an action is the claimant’s possession of an interest in the entity on whose behalf it sues such that the plaintiff has a stake in the outcome. The court said the text of Subchapter J contemplated rather than abrogated this fundamental feature as reflected by its text, including references in Section 101.463 to “‘a derivative proceeding brought *by a member* of a closely held limited liability company’ and ‘a recovery in a direct or derivative proceeding *by a member*,” and additional prerequisites to standing that apply under Section 101.452 to one who is presently a “member.” The

court pointed out that sister courts of appeals have held that the parallel corporate provisions require that shareholder status be maintained throughout the suit, and recent decisions of the Texas Supreme Court addressing derivative suits brought on behalf of closely held corporations “have uniformly presumed a plaintiff who is presently a shareholder.”

In conclusion, the court held that (1) the trial court abused its discretion in holding that Dunster had standing as a former member to pursue derivative claims on LoneStar 1’s behalf and (2) the relators lacked an adequate remedy by appeal after final judgment. Thus, mandamus relief was appropriate, and the court conditionally granted the writ and directed the trial court to vacate its previous order and dismiss Dunster’s derivative claims for want of standing.

### **Charging Order**

*Sky Cable, LLC v. DIRECTV, Inc.*, 886 F.3d 375 (4th Cir. 2018).

After a judgment against an LLC and its sole member went unsatisfied, the district court entered an amended judgment that reverse pierced the veil of three other LLCs owned by the individual and made them co-judgment debtors with the individual. On issues of first impression, the court of appeals affirmed the district court’s decision and held that Delaware law permits the remedy of reverse veil piercing when the LLC is the alter ego of its member.

In 2000, Randy Coley, through his subsequently-defunct East Coast Cablevision, LLC (“ECC”), contracted with DIRECTV, Incorporated (“DIRECTV”) to provide its programming to 168 rooms at a Virginia resort. In 2011, an investigation by DIRECTV revealed a fraudulent scheme pursuant to which ECC and Coley received payment for cable services provided by DIRECTV to over 2,500 units at the resort while continuing to pay DIRECTV only for those services provided to the 168 units. DIRECTV eventually obtained a judgment for \$2.4 million against Coley and ECC for violations of federal communications law based on the unauthorized receipt and distribution of DIRECTV’s programming.

Coley dissolved ECC after the district court entered its judgment, and DIRECTV was unable to collect any payment from Coley, who had few personal assets. Discovery in the post-judgment phase of the case revealed that several LLCs owned and managed by Coley held title to or managed Coley’s assets. DIRECTV filed a motion in the district court to reverse pierce three LLCs owned and managed by Coley in order to obtain access to the assets of these LLCs. These three companies were not parties to the case and had not been served with process. In 2016, the district court entered an amended judgment rendering the three LLCs co-judgment debtors with Coley and held that: (1) under Delaware law, the three LLCs were alter egos of Coley; (2) Delaware would recognize reverse veil piercing under such circumstances; and (3) DIRECTV’s failure to serve process on the three LLCs did not prevent the court from exercising jurisdiction over them. Coley and one of the three LLCs appealed, arguing that Delaware law does not permit reverse piercing of a corporate veil even when the corporation is the alter ego of the judgment debtor, and that Delaware’s LLC charging order statute provides the exclusive remedy for a judgment creditor seeking access to the financial interest of an LLC’s member.

The court of appeals reviewed do novo whether Delaware law would permit reverse piercing of an LLC. The court first discussed corporate and LLC veil piercing in general and distinguished the various types of veil piercing. The court explained that traditional veil piercing permits a court to hold an owner liable for a judgment against the entity, whereas reverse veil piercing imposes liability on the entity for a judgment against an owner. The court further explained that an additional classification of reverse piercing concerns the origin of a request to the court to disregard the entity’s form: “insider” reverse piercing applies when the entity’s controlling owner makes such a request,

whereas “outsider” reverse piercing (relevant here) applies when an outsider/third party (often a creditor) makes the request.

Because the law of the state in which an entity is “incorporated” generally governs the question of whether a court may pierce an entity’s veil, and the parties did not dispute that Delaware law applied to the reverse piercing claim, the court relied on Delaware case law to analyze whether Delaware permits reverse veil piercing. The court discussed Delaware’s recognition of traditional veil piercing as an equitable remedy in exceptional circumstances and noted that the purpose of reverse piercing is to hold a company liable for a member’s actions to prevent fraud or injustice. The court stated that reverse piercing is particularly appropriate when an LLC has a single member because there are no other members whose interests are affected. According to the court, “because Delaware courts apply the alter ego theory only in exceptional circumstances, recognition of reverse veil piercing for the limited purpose of preventing fraudulent conduct would not threaten the general viability of the corporate form in Delaware.” The court noted Delaware’s “powerful interest. . .in preventing entities that it charters from being used as vehicles for fraud,” and the court discerned that Delaware courts have “signaled some willingness to apply a theory of reverse veil piercing.” Thus, the court concluded that “Delaware would recognize outsider reverse veil piercing of an LLC’s veil when the LLC is the alter ego of its sole member.”

The court next analyzed Coley’s contention that Delaware’s LLC charging order statute precluded reverse piercing of his LLC based on the following “exclusivity” provision of the statute:

The entry of a charging order is the exclusive remedy by which a judgment creditor of a member or a member’s assignee may satisfy a judgment out of the judgment debtor’s limited liability company interest and attachment, garnishment, foreclosure or other legal or equitable remedies are not available to the judgment creditor, whether the limited liability company has 1 member or more than 1 member.

6 Del. Code § 18-703(d).

Although Delaware courts have not interpreted this provision, the court found it to be clear that piercing the veil of an alter ego was not the type of remedy the statute was intended to prohibit. The court applied the statutory construction rule of “*ejusdem generis*” and concluded that the general reference to “other legal or equitable remedies” applied only to types of remedies that are similar to those specifically listed, i.e., “attachment, garnishment, [and] foreclosure.” Reverse veil piercing of an LLC when the LLC is the alter ego of its sole member permits the court to treat the LLC as “identical” to its member and effectively eliminates the legal status of the LLC in narrow circumstances involving fraud or injustice. Therefore, the court considered reverse piercing to be unlike the common-law seizure remedies listed in the exclusivity provision of the charging statute. Additionally, the court determined that Coley’s interpretation of the charging order statute would impermissibly limit Delaware’s ability to prevent the entities that it charters from being used as vehicles for fraud.

The court then analyzed Coley’s contention that the district court erred in reverse piercing the veil of Coley’s LLC because the district court failed to make a finding of fraudulent purpose. The appellate court stated that in order to prevail under an alter ego theory, a plaintiff is not required to show “actual fraud but must show a mingling of the operations of the entity and its owner plus an ‘overall element of injustice or unfairness.’” The court stated that an inference may be drawn that entities are one and the same if they fail to follow corporate formalities when doing business with one another. In a footnote, the court noted that “LLCs must observe fewer *internal* formalities than



corporations, but the principle that they should follow ordinary formalities and norms when doing business with other entities is the same.” The court described evidence of commingling of funds, lack of proper accounting records, unexplained transfers of funds, and payments by one LLC of another LLC’s or Coley’s expenses or obligations. The court also concluded that an “overall element of injustice or unfairness” was present because DIRECTV had not yet received any payment on its judgment obtained more than four years ago. Based on this evidence, the appellate court concluded that the district court’s finding of alter ego was not clearly erroneous.

Next the court rejected Coley’s contention that the district court erred in holding that Coley’s participation in the post-judgment proceedings permitted the district court to exercise jurisdiction over his LLC despite the fact that the LLC was not served with process. The appellate court reasoned that when reverse veil piercing a single-member LLC, the individual is already before the district court, and there is no concern that the alter-ego LLC must receive independent notice of a legal action. Thus, the court held that an LLC that is the alter ego of its sole member is properly before the court when the court has jurisdiction over the member.

Finally, the court rejected Coley’s argument that the district court erred in applying the doctrine of equitable estoppel in the post-judgment proceedings with respect to the contention that Mrs. Coley was also a member of his LLC. During the pre-judgment proceedings, Mrs. Coley represented that she was not an owner of any of Coley’s business entities and was not a member of the LLC. Coley also testified that he was the sole member of the LLC and produced an operating agreement that indicated he was the sole member. DIRECTV relied on these representations in dismissing Mrs. Coley. After the judgment was entered, the Coleys sought to establish that Mrs. Coley was a member (in order to oppose reverse piercing the LLC on the basis that it would prejudice Mrs. Coley as an innocent owner), and the court concluded that “[t]he Coleys’ shifting positions reflected an attempt to assert whatever position would advance their quest to avoid liability and place their personal assets beyond the reach of DIRECTV.” Thus, the court held that the district court did not abuse its discretion in estopping the assertion of Mrs. Coley’s interest in the LLC in the post-judgment proceedings.

***Heckert v. Heckert***, No. 02-16-00213-CV, 2017 WL 5184840 (Tex. App. 2017).

The court of appeals held that the trial court did not abuse its discretion in ordering the turnover of a judgment debtor’s interest in a limited partnership and an LLC.

In a personal injury action that Teresa Heckert brought against her ex-husband Clyde Heckert, a jury awarded Teresa \$381,342.27. Teresa filed a motion seeking the turnover of any of Clyde’s nonexempt assets, including his interest in a limited partnership (A2R, Ltd.) and a single-member LLC (Averse 2 Risk, LLC). Both entities were formed after the divorce while Teresa’s personal injury suit was pending against Clyde. The LLC was the general partner of the limited partnership, and Clyde was the sole limited partner. Clyde was also the sole member of the LLC. The limited partnership owned stock that was awarded to Clyde in the divorce.

The court determined that Clyde’s ownership interests in the entities were nonexempt. Nevertheless, Clyde argued that the interests were not susceptible to turnover because, according to Clyde, “sections 101.112 and 153.256 of the Business Organizations Code provide that the exclusive remedy by which a judgment creditor of a limited partnership or limited liability company may satisfy a judgment out of the judgment debtor’s interest in that limited partnership or limited liability company is a charging order.”

The court agreed that “[t]he plain language of sections 101.112(d) and 153.256(d) provides that a charging order is generally the exclusive remedy by which to satisfy a judgment out of the judgment debtor’s interest in a limited partnership or limited liability company.” Nevertheless, the

court noted that “courts have held that there are some exceptions to this rule.” For example, the Dallas Court of Appeals held that the sections do not preclude turnover of a person’s distributions from an LLC or limited partnership. In addition, the Houston (14<sup>th</sup>) Court of Appeals held that “turnover of a member’s interest in a limited liability company was not precluded by section 101.112 ‘when the judgment creditor seeking the membership interest is the entity from which the membership interest derives,’ and when the turnover order ‘involves an explicit award of the membership interest itself from one party to the other as part of the judgment.’” According to the *Heckert* court, “[t]his is because in these types of situations, the purpose of a charging order has not come into play: the charging order was developed to prevent a judgment creditor’s disruption of an entity’s business by forcing an execution sale of the partner’s or member’s entity interest to satisfy a debt of the individual partner or member.”

The *Heckert* court determined that “the same reasoning applies here because neither A2R, Ltd. nor Averse 2 Risk, LLC is an operating business; both entities appear to have been formed by Clyde for the sole purpose of taking ownership of nonexempt assets awarded to him in the divorce.” The court noted that “[n]o other party’s interest will be disrupted by the turnover of those interests and the stock owned by A2R, Ltd.,” and it observed that “Clyde has already assigned his interests and the [stock] to the receiver, subject to his right of appeal.” As a result of this analysis, the court held that the trial court did not abuse its discretion in ordering the turnover of Clyde’s interest in the limited partnership and the LLC.