

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

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### Formation of General Partnership

*Energy Transfer Partners, L.P. v. Enterprise Products Partners, L.P.*, 593 S.W.3d 732 (Tex. 2020).

The Texas Supreme Court held that Texas law permits parties to conclusively negate the formation of a general partnership through contractual conditions precedent. The trial court entered a judgment based on the jury's finding of a partnership as described by statute, but the court of appeals reversed based on conditions precedent contained in certain agreements between the parties. The parties agreed that there would be no binding and enforceable obligations between them unless and until the parties received approval by their respective boards and entered into definitive agreements, and the supreme court held that there was no specific evidence that these conditions were waived; therefore, the court affirmed the court of appeals' reversal of the trial court's judgment.

Two major oil and gas competitors—Energy Transfer Partners, L.P. and Energy Transfer Fuel, L.P. (collectively, “ETP”) and Enterprise Products Partners, L.P. and Enterprise Products Operating LLC (collectively, “Enterprise”)—agreed to explore the viability of a major pipeline project, which they referred to as “Double E.” In three written agreements, ETP and Enterprise expressed their intent that neither party be bound to proceed until each company's board of directors had approved the execution of definitive agreements.

In March of 2011, the parties entered into a confidentiality agreement that laid out the parties' rights and responsibilities with respect to confidential information exchanged during the discussions. The confidentiality agreement stated:

The Parties agree that unless and until a definitive agreement between the Parties with respect to the Potential Transaction has been executed and delivered, and then only to the extent of the specific terms of such definitive agreement, no Party hereto will be under any legal obligation of any kind whatsoever with respect to any transaction by virtue of this Agreement or any written or oral expression with respect to such a transaction by any Party or their respective Representatives, except, in the case of this Agreement, for the matters specifically agreed to herein. . . .

In April of 2011, the parties signed a Letter Agreement with an attached “Non-Binding Term Sheet.” The letter stated:

Neither this letter nor the JV Term Sheet create any binding or enforceable obligations between the Parties and, except for the Confidentiality Agreement . . . , no binding or enforceable obligations shall exist between the Parties with respect to the Transaction unless and until the Parties have received their respective board approvals and definitive agreements memorializing the terms and conditions of the Transaction have been negotiated, executed and delivered by both of the Parties. Unless and until such definitive agreements are executed and delivered by both of the Parties, either [Enterprise] or ETP, for any reason, may depart from or terminate the negotiations with respect to the Transaction at any time without any liability or obligation to the other, whether arising in contract, tort, strict liability or otherwise.

The Non-Binding Term Sheet outlined the basic features of the potential transaction and contemplated that a “mutually agreeable Limited Liability Company Agreement would be entered into” to govern the joint venture.

Finally, also in April of 2011, the parties signed a Reimbursement Agreement that provided the terms under which ETP would reimburse Enterprise for half the cost of the project’s engineering work. That agreement also recognized that the parties were “in the process of negotiating mutually agreeable definitive agreements” for the project and stated that nothing in it would “be deemed to create or constitute a joint venture, a partnership, a corporation, or any entity taxable as a corporation, partnership or otherwise.” ETP’s pleadings stated that “as of the date of [these agreements] . . . the parties had not yet formed a partnership.”

By May, the parties had formed a team to pursue Double E. The key to forming a successful venture was obtaining sufficient shipping commitments, and the parties marketed Double E to potential customers as a “50/50 JV” and prepared engineering plans for the project during the spring and summer. A Federal Energy Regulatory Commission rule governing new interstate pipelines requires an “open season” of 30 to 45 days in which shippers are asked to commit to daily barrel volumes and tariffs. The initial open season was unsuccessful. The parties extended the open season twice more. On the last day of the second extended open season, Chesapeake Energy Corp. made a large commitment to ship, and ETP was hopeful that Chesapeake’s commitment would draw in other shippers who had been holding out. A few days earlier, however, Enterprise had begun preparing its exit by negotiating with a Canadian pipeline company (“Enbridge”), and Enterprise ended its relationship with ETP a few days after the last day of the second extended open season. Enterprise and Enbridge ultimately pursued another pipeline arrangement that became a financial success, and ETP sued.

ETP’s theory at trial was that ETP and Enterprise had formed a partnership to “market and pursue” a pipeline through their conduct, and Enterprise breached its duty of loyalty by pursuing the project with Enbridge. The jury found that “ETP and Enterprise create[d] a partnership to market and pursue a pipeline project to transport crude oil” and Enterprise had not complied with its duty of loyalty. The jury found compensatory damages in the amount of \$319,375,000 and benefit gained by Enterprise as a result of its misconduct in the amount of \$595,257,433. The trial court reduced the disgorgement award to \$150 million and otherwise rendered judgment on the verdict for ETP for a total of \$535,794,777 plus postjudgment interest.

The court of appeals reversed and rendered judgment for Enterprise based on the conditions precedent in the agreements entered into between the parties (and alternatively on the basis that the alleged purpose of the partnership—to market and pursue a pipeline—did not have the potential for profit and that the alleged partnership thus could not satisfy the statutory definition of a partnership as a matter of law). ETP appealed to the Texas Supreme Court.

The Texas Supreme Court first explained that § 152.051(b) of the Texas Business Organizations Code (which contains the Texas General Partnership Law) states that “an association of two or more persons to carry on a business for profit as owners creates a partnership, regardless of whether: (1) the persons intend to create a partnership; or (2) the association is called a ‘partnership,’ ‘joint venture,’ or other name.” Further, § 152.052(a) sets forth the following non-exclusive factors that indicate persons have created a partnership:

- (1) receipt or right to receive a share of profits of the business;
- (2) expression of an intent to be partners in the business;
- (3) participation or right to participate in control of the business;
- (4) agreement to share or sharing:

- (A) losses of the business; or
- (B) liability for claims by third parties against the business; and
- (5) agreement to contribute or contributing money or property to the business.

Section 152.003 provides that “[t]he principles of law and equity and the other partnership provisions supplement this chapter unless otherwise provided by this chapter or the other partnership provisions.”

The court noted that it had characterized the application of the statutory factors in a previous decision as a “totality-of-the-circumstances” test, under which expression of an intent to be partners carries no greater weight than any other factor. The court acknowledged that “under § 152.051(b), persons can create a partnership regardless of whether they intend to,” and the court explained that this provision derives from Section 202(a) of the Revised Uniform Partnership Act, the official comment to which warns that parties “may inadvertently create a partnership despite their expressed subjective intention not to do so.” The court pointed out, however, that it had previously “expressed skepticism that the Legislature ‘intended to spring surprise or accidental partnerships on independent business persons’.” The court stated that it had not previously addressed the question of whether persons may “override the default test for partnership formation in Chapter 152 by agreeing not to be partners until conditions precedent are satisfied.”

Relying on “other ‘principles of law and equity’” and the strong Texas policy favoring freedom of contract, the court concluded that the “parties’ freedom to contract for conditions precedent to partnership formation can override the statutory default test, in which intent is a mere factor.” The court stated that “[a]n agreement not to be partners unless certain conditions are met will ordinarily be conclusive on the issue of partnership formation as between the parties.” In a footnote, the court stated that “[s]uch an agreement would not, of course, bind third parties, and we do not consider its effect on them.”

The court acknowledged that performance of a condition precedent can be waived or modified, but the court stated that ETP was required either to obtain a jury finding on waiver or to prove waiver conclusively, neither of which ETP did. The court explained further that “only evidence directly tied to the condition precedent is relevant. Evidence that would be probative of expression of intent under § 152.051(a)—such as ‘the parties’ statements that they are partners, one party holding the other party out as a partner on the business’s letterhead or name plate, or in a signed partnership agreement’ [footnote omitted]—is not relevant. Nor is evidence that would be probative of any of the other § 152.052(a) factors. Otherwise, a party in ETP’s position could claim waiver in virtually every case.” According to the court, ETP did not point to any evidence that Enterprise specifically disavowed the requirement of definitive, board-approved agreements or that Enterprise intentionally acted inconsistently with that requirement. The court rejected the argument that the effect of the conditions precedent was subsumed in the five factors considered by the jury, and the court stated that the evidence on which ETP relied—that the parties held themselves out as partners and worked closely together on the Double E project—was not relevant to the issue of waiver of definitive, board-approved agreements. Because the court disposed of the case on the basis of the conditions precedent, the court did not address the alternative holding of the court of appeals that the purpose of the partnership alleged by ETP—to market and pursue a pipeline—was not a “for profit” purpose as is required by the statute to create a partnership.

*MAS Associates, LLC v. Korotki*, 214 A.3d 1076 (Md. 2019).

The court held that three individuals who entered into negotiations to form a mortgage lending business by becoming members of an existing LLC did not create a general partnership and that the trial court's finding to the contrary was clearly erroneous.

In the fall of 2009, Harry Korotki, Joel Wax, and Mark Greenberg entered into negotiations to merge their licensed mortgage lending companies and operate them as one. The surviving entity of the merger was to be MAS Associates, LLC ("MAS"), which was owned 91% by Greenberg's wife before the merger and which was to be owned by Korotki, Wax, and Greenberg, along with another existing minority member of MAS, after the merger. Each party was represented by its own counsel, and they also retained regulatory attorneys to create a "neutral" draft of the parties' business arrangement. The regulatory counsel drafted and circulated a summary of the parties' meeting memorializing their goal of becoming members of MAS in specified percentages. The summary of the meeting also reflected that the potential arrangement would be structured into an interim period and a post-interim period. During the interim period, Korotki and Wax would be employees of MAS until approvals and licensing were obtained, they would be entitled to receive one-third of the profits, their companies would be liquidated, and their mortgage licenses would be surrendered. In November 2009, the regulatory counsel provided drafts of an "Interim Agreement" outlining the interim period before Korotki, Wax, and Greenberg were to become members in a manner similar to the earlier summary and an "Operating Agreement Outline" contemplating each party's obligations post-membership. As contemplated by the interim agreement, the three men each made indirect contributions to MAS of \$150,000 by making payments to Greenberg's wife. Negotiations over the Interim Agreement and the Operating Agreement Outline continued for several months. Around this same time, the business began experiencing losses and the parties did not finalize the agreements because they did not want to spend more money on attorney's fees. By summer 2010, MAS was beginning to make a profit, and the parties decided to begin drawing a salary of \$10,000 per month each. As of November of 2010, the parties still contemplated becoming members or owners of MAS and anticipated signing the Interim Agreement by the end of the year. After year-end distributions of commissions and income to the three men, they each made an additional contribution to MAS of \$125,000 by again making a payment to Greenberg's wife. As MAS began to grow, its need to secure additional lines of credit increased. As collateral to secure a line of credit, Greenberg and Wax agreed to pledge their own personal resources. Korotki, however, refused to be personally liable for any amounts exceeding his one-third share, which eventually led to the unraveling of the venture. In the spring of 2011, Korotki informed Greenberg and Wax of his decision to quit. When Greenberg, Wax, and Korotki failed to negotiate the terms of Korotki's departure and buyout, Korotki sued for breach of contract and declaratory judgment under the Revised Uniform Partnership Act. The trial court ruled that the parties intended to form a partnership. Greenberg and Wax appealed, and the Maryland Court of Special Appeals affirmed the trial court's ruling. Greenberg and Wax sought review by the Maryland Court of Appeals, which granted their petition.

The court first generally discussed the nature of LLCs and general partnerships, explaining that LLCs are creatures of statute formed pursuant to the Maryland Limited Liability Company Act. In contrast to an LLC, which is formed by the execution and filing of articles of organization, there are no formal requirements to form a partnership. The Maryland Revised Uniform Partnership Act ("RUPA") defines a partnership as "the unincorporated association of two or more persons to carry on as co-owners a business for profit ...", and provides that a partnership can result whether the individuals expressly "intend[ed] to form a partnership and whether or not the association is called 'partnership,' 'joint venture,' or any other name." An "unincorporated association or entity created under a law other than" RUPA or another state's partnership law "is not a partnership." The

existence of a partnership depends on the intent of the purported partners, which may be proved by an express agreement or inferred from conduct. The court cited the following statutory rules applicable to the determination of whether a partnership was formed: “(1) joint tenancy or ownership of property ‘does not by itself establish a partnership’; (2) sharing ‘gross returns does not by itself establish a partnership, even if the persons sharing them have a joint or common right or interest’ in the property generating the returns; and (3) any person receiving ‘a share of the profits of a business is presumed to be a partner,’ unless such share is received in the payment of debt, wages or services rendered, rent, annuity or benefit, interest on a loan, or sale of a business or property. Corps. & Ass’ns § 9a-202(D)(1)-(3).”

It was undisputed that there was no enforceable written agreement; therefore, the court examined whether there was competent material evidence for a factfinder to conclude that the parties formed a general partnership. Wax and Greenberg argued that the trial court conflated two distinct forms of business entities—LLCs and partnerships. They asserted that the trial court erred in ruling that a lawfully formed LLC could simultaneously be the vehicle for operating a separate unnamed “combined mortgage lending business” partnership. In other words, they argued that the trial court ignored the statutory language preventing organizations formed under other statutes from being partnerships. Although the court agreed that an LLC cannot simultaneously be a partnership, the court also agreed with Korotki that it is possible to construct a scenario where the existence of a partnership and LLC are not mutually exclusive. “Most relevant here, one could imagine a scenario where parties intend to become members of an existing LLC but abandon that attempt in favor of a partnership. It is also not inconsistent with the statutory language, *per se*, for an association conducting its operations in conjunction with an LLC to intend to form a partnership. The question is whether the parties have done so in this case, and, accordingly, we turn to a close analysis of the record.”

The court first discussed the negotiations to form an LLC, discussing at some length a Delaware case relied on by Greenberg and Wax. In *Ramone v. Lang*, No. Civ.A. 1592-N, 2006 WL 905347 (Del. Ch. Apr. 3, 2006), the court concluded that there was no partnership between the parties because “to find that their failure to reach accord on an LLC agreement, without more, left them as general partners would be inequitable and unprincipled, given the reality that they never agreed on their obligations to one another.” The parties’ agreement was nothing more than an engagement “to get engaged,” which is not sufficient to form a general partnership. The court found this case to present a similar situation, and stated that the most important factor in this case was that the parties never abandoned their efforts to become members of MAS. According to the court, “[a]ctions consistent with [the parties’] mutual understanding [to become members of an LLC] could not fairly contribute to an implied partnership.”

The court next discussed management and control of the entity, which is a factor that courts commonly examine to evaluate partnership intent. Wax and Greenberg argued that the parties’ roles were consistent with being managers in a manager-managed LLC and that referring to each other as partners, in the colloquial sense, is not indicative of a partnership. They also asserted that MAS was the only entity through which the parties operated. Korotki argued that the parties made decisions only after consulting each other and that each had equal control in the management process, pointing out that the parties were all signatories on the business bank accounts, they referred to each other as partners, and employees referred to them as partners. The court viewed the evidence of shared management as consistent with the typical high-level managerial responsibilities of an LLC manager, and the parties were negotiating to become members in MAS, first becoming managers of MAS, which was a manager-managed LLC. Thus, the court did not consider the managerial activities of the parties as supporting an intent to form a partnership. The court also attached no weight to the

colloquial use of “partner,” which the court pointed out was mostly used by Korotki. The court also pointed out that none of the parties protested their holding out to the world that they were operating within the structure of an LLC.

The court next discussed Korotki’s argument that his capital contributions showed he was an equal owner of a new entity formed with Wax and Greenberg. The court acknowledged that a “common factor courts use to determine whether parties intended to form a partnership is whether they made capital contributions to the endeavor.” However, the court did not view the payments that were made to Greenberg’s wife, which were then transferred to MAS, as a contribution to a partnership. The court explained that “[t]he trial judge treated these payments as if they were made to a partnership under the guise of capital contributions to an LLC. But to accept this conclusion would be to treat a capital contribution to an LLC as a capital contribution to a partnership—as if the entities were one-in-the-same—which is expressly prohibited by Corps. & Ass’ns § 9A-202(c).” The court concluded that the evidence and law necessitated a finding that the payments to Greenberg’s wife were actually loans rather than capital contributions to a new entity, and a loan is not evidence of partnership intent.

Finally, the court discussed the evidence with respect to the sharing of profits and losses. Wax and Greenberg argued that any profits Korotki received should be characterized as wages because Korotki was considered an employee of MAS and received a W-2 form showing his wages. They asserted that the evidence was consistent with MAS being a manager-managed LLC and Korotki being a manager. In addition, they testified that the parties never agreed to share losses equally and that the evidence showed Korotki’s unwillingness to share MAS’s liabilities equally. Korotki asserted that he received a share of profits, rather than wages, and that RUPA thus presumes him to be a partner. He claimed that the parties took “draws” on profits in the amount of \$10,000 per month and shared profits, though not commissions, equally. He argued that the fact that he was paid in W-2 wages did not make the payments employment wages. The court found the evidence that the parties intended to be employees of MAS during the interim period before membership to be overwhelming, and the court stated that the regular payments of \$10,000 per month, which were denoted as salary on MAS’s payroll, were compensation that did not contribute to any presumption of partnership. The court attached importance to the fact that MAS and all three men treated all payments as wages, not profits. Additionally, the court found it significant that Korotki never agreed to be equally liable for the debts incurred by the purported partnership. He refused to co-sign a warehouse line of credit or an indemnity agreement covering his share of liabilities from the line of credit.

In sum, the court concluded that evidence of equal control and joint decision-making authority did not in these circumstances support a conclusion of partnership. Further, the trial court erred when it classified Korotki’s \$275,000 in payments to Greenberg’s wife, the 91% member of MAS, as capital contributions rather than loans. Further, any presumption of partnership based on profit sharing was undone by the parties’ unabandoned intent to become members of MAS and their treatment of payments from MAS as wages. Moreover, Korotki resisted being held jointly and severally liable for the debts of the purported partnership. For these reasons, the record lacked the necessary evidence to conclude that the parties intended to form a partnership.



## Veil Piercing

*In re Schaefers*, BAP No. CC-20-1067-SGL, Bk. No. 9:19-bk-11163-MB, 2020 WL 7687871 (B.A.P. 9th Cir. 2020).

After a state court relied on reverse veil-piercing principles to conclude that an individual debtor's LLC was his alter ego for purposes of allowing a creditor of the individual to reach the property of the LLC, the BAP affirmed the bankruptcy court's rejection of the individual debtor's attempt to use reverse veil piercing to claim a homestead exemption in the LLC's real property where the individual resided.

Blizzard Energy, Inc. (Blizzard) obtained a \$3.8 million judgment against Bernd Schaefers, and Schaefers filed for bankruptcy protection. Schaefers listed a 50% membership interest in BKS Cambria, LLC in his bankruptcy schedules, valuing the interest at \$5,000,000. Schaefers only claimed his car, furniture, and clothes as exempt assets. Blizzard petitioned the bankruptcy court for relief from the stay so that it could proceed in state court with a pre-petition motion to include the LLC as an additional judgment debtor under a reverse alter-ego theory. The bankruptcy granted the relief, and the state court issued a tentative decision detailing why it intended to hold the LLC liable for Schaefers' judgment debt.

The next day, Schaefers amended his bankruptcy petition. In particular, Schaefers added a \$175,000 homestead exemption claim in the LLC. According to Schaefers, the LLC's property consisted of a decommissioned Air Force base. The former airbase included a four-bedroom officers' quarters in which Schaefer had resided since 2014.

Blizzard objected to the proposed exemption on three grounds. First, the LLC owned the property, not Schaefers. Schaefers simply held a personal property membership interest in the LLC, not the LLC's real property assets. Second, the LLC did not qualify as a "residence" under California law, and so Schaefers could not claim a homestead exemption for the LLC. Finally, Schaefers could not invoke the state court's alter-ego finding in order to disregard the LLC's separate existence for his own benefit.

After a hearing, the bankruptcy court sustained Blizzard's objection. The bankruptcy court considered each of Blizzard's grounds for objection and agreed with each. Schaefers appealed to the Bankruptcy Appellate Panel.

Although the Bankruptcy Code provides a laundry list of federal exemptions to the property of an individual debtor's estate, states may opt out of the federal list and instead provide debtors with exemptions under state law. California has elected to do so. Thus, the BAP first observed that California's exemption law controlled Schaefers' homestead exemption claim.

On the one hand, California law broadly defines the homestead to include any residence where a person resides. As a result, Californians can assert a homestead exemption without holding a fee simple interest in the subject property. In fact, California courts have gone so far as to recognize that a beneficial interest is sufficient to support a homestead exemption. Nevertheless, the BAP determined that Schaefers was trying to push the boundaries of the California homestead exemption too far. Schaefers did not assert that he had either an equitable or beneficial interest in the real property. Rather, he conceded that his interest was in the LLC. California law recognizes limited liability companies as separate and distinct legal entities from their owners, and members do not have an interest in the company's assets. The homestead exemption applies to real property interests. Schaefers' LLC membership interest was personal property.

Next, the BAP turned to Schaefers' argument that the state court's alter-ego finding established his equitable interest in the real property. The BAP held that Schaefers' contention misapprehended the legal effect of an alter-ego determination. The court recognized that common-

law principles of alter-ego liability apply to LLCs and their members under California law, and a judgment creditor may utilize the alter-ego doctrine in order to reverse pierce the LLC veil and reach its assets to enforce a judgment against an individual member. Alter ego is not, however, a claim or cause of action that treats the owner and the company as the same legal entity for all purposes. Typically, the separate existence of an entity is disregarded so that the owners will be liable for the acts of the entity or vice versa. Veil piercing almost never allows the person who actually dominates and controls the company to disregard the separate existence. Alter ego is intended to avoid inequitable results, not to avoid the consequences of organizing and operating a business entity.

While California law recognizes that a corporation can—in limited circumstances—disavow the corporate form when doing so prevents injustice, Schaefer did not independently disavow the LLC's separate existence or explain how recognizing the LLC's separate existence would result in injustice. Schaefer merely attempted to bootstrap the state court's alter-ego finding—which was based on his own inequitable conduct—to avoid the consequences of his decision to create an LLC. The BAP rejected this attempt.

In sum, Schaefer's interest in the LLC could not support a homestead exemption under California law, and the BAP refused to disregard the LLC's separate existence for that purpose.

***In re All Terrain, LLC*, 622 B.R. 770 (Bankr. D. Idaho 2020).**

The bankruptcy court rejected the application of veil-piercing principles (specifically, the single-business-enterprise theory) to support a creditor's assertion of one LLC's breach of contract against a commonly owned LLC. The court further questioned whether veil piercing is ever necessary in a bankruptcy context due to the availability of bankruptcy's substantive consolidation doctrine.

Paul Hathaway was the sole member and agent for two limited liability companies: Hathaway Homes Group, LLC (HHG) and All Terrain, LLC (All Terrain). Hathaway was a heavy gambler and spent millions from both his companies to fund his bets. Hathaway, HHG, and All Terrain all filed for bankruptcy protection.

Robert Edwards entered into a contract with HHG to purchase a mobile home and lot. HHG did not deliver the home and failed to provide the land company with Edwards' down payment for the lot. Edwards did not have any contractual relationship with All Terrain. Nonetheless, Edwards sought to assert his claim against All Terrain. In particular, Edwards argued that the distinction between All Terrain and HHG was arbitrary because Hathaway freely transferred funds between both entities, some of which were used to bankroll his gambling habit, and because the "books" of each company were unreliable. Consequentially, Edwards asserted that the court should pierce HHG's veil to allow recovery against All Terrain.

All Terrain's trustee objected to Edwards' claim on the basis that Edwards was attempting to recover against a party that did not stand behind HHG's veil. Hathaway—not All Terrain—was HHG's sole member.

The court first characterized Edwards' claim as an assertion that All Terrain and HHG constituted a single business enterprise. The single-business-enterprise theory is a controversial theory of veil piercing under which joint liability is imposed against multiple entities that share common ownership. In essence, the theory rests on the idea that the commonly controlled enterprises have so integrated their operations and resources that their separate identities effectively merge into a single business enterprise. The theory operates to disregard the separate identity of enterprises that in fact operate as one where necessary to avoid an unjust or inequitable result.

The court then considered whether Idaho law recognizes the single-business-enterprise theory. It did not appear that any Idaho court had addressed the issue, but the court noted that Utah

had addressed the issue and that veil piercing under Utah law was substantively similar to Idaho. Existing Utah case law rejects the theory. Furthermore, the court noted that the Idaho Supreme Court came close to addressing the single-business-enterprise theory in *Wandering Trails, LLC v. Big Bite Excavation Inc.* In *Wandering Trails*, the Schelhorns owned two entities, Piper Ranch and Big Bite. Piper Ranch entered a contract with Wandering Trails to pave roads in a residential development. When Piper Ranch failed to perform, Wandering Trails sued Piper Ranch, the Schelhorns, and Big Bite. The Idaho Supreme Court stated that there was no evidence that Big Bite stood behind Piper Ranch. Veil piercing is generally premised on the idea that an entity is an individual's alter ego, but connecting Piper Ranch to Big Bite through the Schelhorns would require a finding that the Schelhorns were the alter ego of Big Bite, and the Idaho Supreme Court said that individuals have no veil to pierce. According to the court, attempting to pierce Piper Ranch's veil to hold Big Bite liable simply did not work.

The court found *Wandering Trails* instructive despite not being squarely on point. In deciding whether one entity stood behind another, the Idaho Supreme Court applied traditional veil-piercing doctrine and did not utilize any other theory. Unlike *Wandering Trails*, in which it was alleged that Big Bite was an entity that stood behind Piper Ranch, there was no allegation in this case that All Terrain was behind HHG. Edwards sought to assert a claim against All Terrain through Hathaway's control of both entities. In other words, if HHG and All Terrain are both alter egos of Hathaway, Edwards reasoned that a claimant against one should be able to pursue the other because of the way Hathaway conducted himself when controlling both entities. Nevertheless, *Wandering Trails* illustrated Idaho's caution toward non-traditional veil-piercing theories, and the court determined that the Idaho Supreme Court would not choose to adopt the single-business-enterprise theory.

The court further questioned whether veil piercing was ever necessary in a bankruptcy context. In particular, bankruptcy's substantive consolidation doctrine allows a bankruptcy court, in certain circumstances, to disregard the separate identities of related entities and pool their assets and liabilities to achieve equality of distribution and fairness to creditors. The court did not find it appropriate to take up the matter of substantively consolidating the bankruptcy cases at this stage since no party had moved the court to do so.

***Dill v. Rembrandt Group, Inc.***, 474 P.3d 176 (Colo. App. 2020).

The court of appeals reversed and remanded the trial court's judgment in favor of a subordinate creditor that horizontally pierced the veil between the debtor-corporation and senior creditor-LLC in order to extinguish the senior debt once acquired by the LLC. As a matter of first impression, the court held that Colorado law permits horizontal veil piercing between sister entities only if the entities share a parent or common owners in the ownership chain and the veil of each separate entity is also pierced. The court of appeals further held that there was insufficient evidence to support the trial court's findings that the debtor-corporation and its senior creditor-LLC were alter egos or that the senior creditor-LLC was formed to defeat the rightful claim of the subordinate creditor.

In 2000, Rembrandt Group, Inc. ("RGI") financed the purchase of several trade schools from Ernest Dill by borrowing \$3.69 million from Rocky Mountain Mezzanine Fund II, L.P. ("RMMF"), as evidenced by a note (the "RMMF Note"). As a condition of the financing, RMMF required Dill to execute an Intercreditor and Subordination Agreement (the "IC Agreement"), which included provisions that RMMF was the senior creditor, that the RMMF Note was the senior debt, and permitting RMMF to assign the RMMF Note. The IC Agreement also authorized RMMF to issue a payment blockage notice to suspend RGI's payments to Dill if RGI defaulted on the senior debt. In 2008, RGI defaulted on its obligations to Dill. As part of a settlement with Dill, RGI executed two

new promissory notes payable to him (the “Dill Notes”) and he reaffirmed the IC Agreement. In 2011, five individuals who collectively owned 81.25% of RGI (the “Five Common Owners”) formed Intellitec Executives, LLC (“Intellitec”). The Five Common Owners then formed Pikes Peak Acquisitions, LLC (“PPA”) with Intellitec as its single member. PPA purchased the RMMF Note in 2012 for the discounted price of \$1.5 million. RMMF assigned its rights under the RMMF Note and the IC Agreement to PPA. RGI later defaulted on the RMMF Note but continued making payments to Dill under the Dill Notes until exercising its right to defer payment under that agreement. Then, pursuant to the IC Agreement, PPA issued a payment blockage notice to Dill prohibiting him from receiving payments on the Dill Notes until the senior debt was fully satisfied.

On December 30, 2015, Dill sued RGI, asserting claims that included breach of the Dill Notes. PPA intervened. Dill argued that RGI and PPA were alter egos because they shared common owners indirectly through Intellitec. He also argued that the senior debt was extinguished when RMMF assigned the RMMF Note to PPA, which allowed RGI to purchase its own debt at a discount through PPA. After a bench trial, the trial court found that RGI and PPA were alter egos, that PPA was a “shell corporation” formed by Intellitec for the purpose of avoiding creditors, including Dill, and that piercing the veil would yield an equitable result by extinguishing the senior debt and allowing Dill to obtain what he bargained for. RGI and PPA (collectively, the “Appellants”) appealed.

The court of appeals began its analysis by citing Colorado case law for traditional LLC and veil-piercing principles as well as for the proposition that a court must conduct the following three-part test to pierce the veil in Colorado: (1) whether the entity subject to piercing is the alter ego of the person or entity in issue; (2) if so, whether the fiction of the “entity’s veil” was used to perpetuate a fraud or defeat a rightful claim; and (3), if so, whether disregarding the entity form would achieve an equitable result. The court explained that an alter-ego relationship exists when an entity, such as a corporation or LLC, is merely an instrumentality for the transaction of its owners’ affairs and “there is such a unity of interest in ownership that the separate personalities of the [entity] and the owners no longer exist.” The court listed the following factors, not all of which need be present, that are considered to determine whether unity of interest exists: (1) the corporation or LLC operates as a distinct business entity; (2) the two entities commingle funds and assets; (3) the two entities maintain inadequate entity records; (4) the nature and form of the entities’ ownership and control facilitates misuse by an insider; (5) the corporation or LLC is “used as a ‘mere shell’”; (6) “the business [i]s thinly capitalized”; (7) legal formalities are disregarded; and (8) entity funds or assets are used for nonentity purposes.

The Appellants contended that the trial court erroneously pierced the veil to find that RGI’s debt was extinguished when PPA acquired the RMMF Note. They first argued that veil piercing cannot apply “horizontally” to two separate entities not in a parent-subsidary relationship that share no common owners. Alternatively, the Appellants argued that if horizontal piercing applies, then it occurs only if the veils separating each entity and a common parent or owner in the ownership chain are first pierced by establishing that each entity and its owners are alter egos.

According to the trial court, at the time PPA acquired the RMMF Note, RGI and PPA neither had any ownership interest in nor controlled the other. Instead, the Five Common Owners controlled 81.25% of RGI’s shares and were the only members of Intellitec, PPA’s single member. The court of appeals noted that sister entities are those that share common owners or parents and the horizontal piercing of sister entities was a matter of first impression in Colorado. Thus, RGI and PPA were sister entities because the Five Common Owners with an interest in RGI also owned the LLC that owned PPA. The court then reviewed veil piercing in other jurisdictions and observed that some categorically bar piercing the veil between entities that are not in vertical, or parent-subsidary,

relationships. The court noted that these jurisdictions, unlike Colorado, typically do not recognize reverse veil piercing. In a footnote, the court of appeals stated that the Colorado Supreme Court has held that Colorado law allows reverse veil piercing and explained that reverse piercing occurs when an entity outsider seeks to hold the entity liable for the obligations for an entity insider. The court added that this is the opposite of traditional veil piercing, which imposes liability on the entity owners for the obligations of the entity, though the same three-part test used in traditional veil piercing also applies to reverse veil piercing. The court stated that jurisdictions in which horizontal piercing is recognized require a party seeking to disregard the veil separating sister entities to first pierce the veils separating each entity from their shared entity parent and these jurisdictions typically (with the exception of Alabama) recognize reverse veil piercing. The court went on to say, however, that horizontal piercing between sister entities can still occur, even in jurisdictions that do not explicitly recognize reverse veil piercing, when the veil-piercing elements are satisfied. In this regard, the court noted in a footnote that it did not consider the single-enterprise rule in this case because Colorado courts have not recognized the single-enterprise rule, nor had the parties raised it on appeal. Because the Colorado Supreme Court has not explicitly barred horizontal piercing and it has recognized reverse veil piercing, the court of appeals rejected the Appellants' first argument that Colorado courts may never pierce the veil to reach sister entities.

Although the court of appeals rejected the Appellants' argument that Colorado courts may never pierce the veil to reach sister entities, the court agreed with the Appellants' alternative argument that Colorado law permits horizontal veil piercing between sister entities under the traditional veil-piercing test only if the entities share a parent or common owners in the ownership chain and the veils separating each entity from the parent or common owner are first pierced to find that each sister entity is the alter ego of its owners. In order to horizontally pierce the veils of RGI and PPA, the court pointed out that Dill would need to do the following: first, pierce the veil separating RGI from the Five Common Owners to hold the Five Common Owners liable for RGI's actions; second, pierce the veil separating the Five Common Owners from Intellitec to hold Intellitec liable for the actions of the Five Common Owners; and third, pierce the veil separating Intellitec and PPA to hold PPA liable for the obligations of Intellitec. Thus, horizontal veil piercing results from the sequential application of the traditional piercing and the reverse piercing doctrines. The court then conducted an alter-ego analysis of each link in the ownership chain. Beginning with RGI and the Five Common Owners, the court concluded that the record did not support a finding that RGI was the alter ego of the Five Common Owners primarily because there was no evidence of several factors, namely if RGI was undercapitalized, failed to follow corporate formalities, commingled assets with the Five Common Owners, or operated as a "mere shell." Therefore, the court concluded that the veil separating RGI and the Five Common Owners could not be pierced and, as a result, RGI and PPA could not be alter egos. The court reasoned that the only means of piercing the veil between RGI and PPA was to show that the Five Common Owners exercised dominion and control over PPA through Intellitec because Intellitec, and not the Five Common Owners, owned PPA. However, the court concluded that nothing in the record showed that Intellitec and the Five Common Owners were alter egos. Furthermore, the court noted that the trial court had not found that Intellitec was the alter ego of RGI or PPA. Absent this finding, the court concluded that PPA could not be the alter ego of the Five Common Owners nor could RGI and PPA be alter egos. Because the record lacked any evidence that RGI was the alter ego of the Five Common Owners, that the Five Common Owners were the alter ego of Intellitec, or that Intellitec and PPA were alter egos of each other, the court of appeals held that the trial court erred by piercing the veils of RGI and PPA.

The court of appeals further held that, even if RGI and PPA were alter egos, there was insufficient evidence to support the trial court's finding that PPA was formed to defeat Dill's rightful

claim. The court pointed out that the trial court never explained how the ownership structure defeated Dill's claim or harmed him and it did not cite any evidence that PPA was formed to avoid creditors. According to the court, Dill did not point to any evidence indicating that the assignment from RMMF to PPA was anything other than a lawful business transaction, and nothing in the record showed that the assignment was intended to defeat his claim against RGI on the Dill Notes. Instead, the court observed that the conduct of RGI and PPA was consistent with the various agreements and that Dill benefitted from PPA's flexible conduct that permitted him to receive some payments from RGI even after it was in default.

In sum, the court of appeals held that horizontal veil piercing may occur between entities that do not share direct common owners, but that indirectly share common owners through another entity in an ownership chain; however, the veils between the separate entities and their owners in the ownership chain must first be pierced. Because nothing in the record showed that RGI was the alter ego of the Five Common Owners, that Intellitec was the alter ego of the Five Common Owners, or that PPA and Intellitec were alter egos of each other, the court erred by finding that RGI and PPA were alter egos of each other and, consequently, that RGI's senior indebtedness was extinguished.

***Bonanni v. Horizons Investors Corp.***, 179 A.D.3d 995 (N.Y. App. Div. 2d 2020).

The appellate court affirmed the trial court's judgment in favor of an ousted 20% LLC member on direct and derivative claims brought by the ousted member. The appellate court held that the ousted member was entitled to an accounting from a successor LLC based on the defacto merger doctrine even though the original LLC was not formally dissolved; the business judgment rule did not protect the defendants from liability for their decision to "effectively cancel or seize" the ousted member's interest in the LLC; the individual sole owner of a corporation that was a 40% member of the LLC was personally liable for damages based on veil-piercing grounds where the individual manipulated and dominated the LLC in a manner that resulted in wrongdoing injuring the ousted member; the 40% member and its individual owner were properly held jointly and severally liable for all of the damages suffered by the LLC on the tort theories of liability forming the basis of the derivative claims, but proportional responsibility for damages was appropriate with respect to the damages suffered by the ousted member based on the deprivation of distributions since those theories were primarily contractual in nature.

In 2001, MRI Enterprises, LLC ("MRI LLC") was formed by Luciano Bonanni, acting through his wholly owned corporation, MRI Enterprises, Inc. ("MRI Inc."), Benito Fernandez, acting through his wholly owned corporation, Horizons Investors Corp. ("Horizons"), Solomon Kalish, acting through his wholly owned corporation, Adex Management Corp. ("Adex"), and Allan Hausknecht, a physician. MRI LLC's purpose was to provide MRI services to local hospitals. MRI Inc., Adex, and Hausknecht each held a 20% interest in MRI LLC, and Horizons held the other 40%. Because nonphysicians are not permitted to provide medical services, the members of MRI LLC also formed Comprehensive Imaging of New York, PLLC ("CINY"), of which Hausknecht owned 99% and another physician owned 1%, to provide the medical services to the hospitals.

In 2005, a dispute arose amongst the members of MRI LLC regarding which MRI scanners should be purchased for a client hospital. Bonanni managed day-to-day operations of MRI LLC and was excluded from management of MRI LLC after a particularly contentious meeting. Kalish took over Bonanni's duties, and the members discussed the respective rights and duties of Bonanni/MRI Inc. and the remaining members, but the remaining members never acquired MRI Inc's interest in MRI LLC. They also failed to include MRI Inc. in any future distributions.

After concluding that MRI Inc. was entitled to an accounting from CINY as a successor in a de facto merger of MRI LLC with CINY and that the business judgment rule did not protect the

defendants' decision to effectively cancel or seize MRI Inc.'s 20% interest made after Bonanni had ceased management of MRI LLC, the court addressed whether Fernandez could be held individually liable based on veil piercing. Fernandez contended that he should not have been held personally liable for the damages awarded against Horizons, much less for the entire amount of damages awarded to MRI LLC, because the owners of a corporation are not personally liable for the obligations of the corporation. The court stated that to pierce the corporate veil a plaintiff must show that (1) the owners exercised complete domination of the corporation in respect to the transaction attacked and (2) that such domination was used to commit a fraud or wrong against the plaintiff resulting in the plaintiff's injury. The court listed factors commonly examined in a veil-piercing analysis and concluded that the record showed as a whole that Fernandez exercised complete domination of MRI LLC and did so in a manner that resulted in a fraud or wrong injuring MRI Inc. The plaintiffs' forensic accountant identified numerous suspicious or unusual financial transactions as well as "a specific transaction in which it appeared that Fernandez was 'trying to manipulate the books' to hide a transaction, and another series of transactions that appeared to be a liquidation of an account which held approximately \$220,000 but which excluded MRI Inc. from the distribution." Furthermore, the court characterized "the seizure of MRI Inc.'s 20% interest in MRI LLC with no process and no payment to MRI Inc." as a "failure to adhere to corporate formalities," and the court stated that "the manipulation of transactions between MRI LLC and CINY resulted in a 'commingling of assets' and/or the 'use of corporate funds for personal use.'"

With regard to the trial court's imposition of joint and several liability on Fernandez, the court concluded: "Since we agree with the Supreme Court's determination to pierce MRI LLC's corporate veil to hold Fernandez personally liable, we agree with the court's determination to impose joint and several liability against [Fernandez and Horizons] with respect to the damages award in favor of MRI LLC on the tort theories of looting, waste, and misappropriation of assets and corporate opportunities." However, the appellate court also agreed with the trial court's determination not to impose joint and several liability against Fernandez for the entire damages award in favor of MRI Inc. The appellate court agreed with the trial court's decision to impose liability for MRI Inc.'s share of distributions by MRI LLC in proportion to the interests of the remaining members (i.e., Fernandez and Horizons were held liable for 50%, Adex and Kalish for 25%, and Hausknecht for 25%) because the trial court was able to determine the proportions in which the defendants profited from the seizure of MRI Inc.'s share in MRI LLC, and the theories under which MRI Inc. recovered against them were primarily contractual in nature.

***Mattingly Law Firm, P.C. v. Henson***, 466 P.3d 590 (Ok. Ct. App. 2019).

The court held that reverse veil piercing of an LLC is permitted under Oklahoma law and that the facts warranted reverse piercing two LLCs in this case. The court recognized the concept of an equitable owner for veil-piercing purposes such that the two LLCs at issue could be characterized as the alter egos of the non-member spouse of the LLCs' sole member based on the non-member spouse's exercise of control over the LLCs.

A law firm (the "Firm") obtained a default judgment against Melvin Henson in an action for unpaid fees owed by Henson for services provided by the Firm. After multiple hearings where Henson failed to provide evidence of his assets, the trial court ordered Henson to provide "corporate books of any and all LLC[s] [Henson] is associated with, including all records from Henson Farms, LLC and Henson Insurance Group, LLC. Henson to also provide all bank statements in which he has signing privileges." At a hearing several years after the default judgment was entered, Henson presented the operating agreement for Henson Insurance Group, LLC, bank statements from two bank accounts for the Insurance Group, and statements from one bank account for Henson Farms,

LLC. Henson testified that he worked “at the LLCs” but never drew a paycheck from either. He also testified that he sometimes used funds from the LLC bank accounts for personal purposes, but upon further questioning admitted he and his wife essentially “lived out” of the LLC accounts.

The Firm moved for a charging order against Henson’s potential interest in the LLCs. After that motion was filed, Henson was removed from having signing privileges for the bank accounts for both LLCs as a result of a “special meeting” of the LLCs’ sole member—Henson’s wife. At the hearing on the motion for a charging order, the Firm’s counsel testified that the bank account records from the two LLCs revealed that 53% of the account transactions were cash withdrawals, 99% of which were withdrawn by Henson. The Firm’s counsel also testified that the accounts did not reflect any paychecks deposited or paid. Henson and his wife both testified that Henson had never owned an interest in the LLCs and that the LLC bank accounts were not personal in nature. The Firm argued to the trial court that it should be permitted to attach the LLCs’ assets in satisfaction of the judgment against Henson based upon the doctrine of “piercing the corporate veil.” The trial court agreed and granted a charging order against Henson’s “50% interest” in the entities. The trial court also held that the LLCs were “alter egos” of Henson and that the veil of the entities should be pierced because (1) the LLCs were undercapitalized; (2) Henson failed to maintain books for the LLCs separate from his personal finances; (3) finances of the LLCs were not kept separate from Henson’s finances and Henson had used LLC funds to pay personal obligations; and (4) Henson failed to maintain LLC formalities.

The court of appeals characterized the “single issue on appeal” as “whether the trial court properly granted the charging order by determining the LLCs were Henson’s ‘alter egos’ and the court should pierce the corporate veil of the entities.” The court began by pointing out that Oklahoma’s LLC statute provides that the exclusive remedy of a member’s creditor with respect to the member’s interest is a charging order that cannot be foreclosed upon, and the Firm relied on “reverse piercing,” a doctrine distinct from traditional piercing of the corporate veil. The court explained that reverse piercing involves holding a business entity—such as an LLC or corporation—responsible for the liabilities of an individual member or shareholder (i.e., the opposite of traditional piercing). The court stated that reverse veil piercing has never been explicitly recognized in Oklahoma in any context, and the Oklahoma Supreme Court has never applied any form of veil piercing to LLCs. The court also stated that Oklahoma has not yet applied corporate veil piercing against an individual who holds no formal financial interest in the business entity.

Henson strenuously argued that he was not a member of either of the LLCs, but was, ostensibly, a manager of the businesses. The court of appeals acknowledged that, under Oklahoma law, charging orders are ordinarily granted regarding a member’s interest in an LLC, and the court stated that non-member managers of LLCs are not traditionally deemed to have a “membership interest” against which a charging order may be granted.

The court of appeals characterized the trial court’s order as “combin[ing] the equitable doctrine of piercing the corporate veil with the statutory mechanism of an LLC charging order” and further explained:

Piercing and reverse piercing of the corporate veil allows an obligee to access all of the assets of the individual or entity on the other side of the veil, treating the pierced entity as synonymous with the obligor-defendant. On the other hand, a charging order allows a creditor to attach only a member’s capital interest in an LLC. 18 O.S. Supp. 2017 § 2034. “Membership interest” is defined by statute as “only the flow of profits or surplus from the member’s economic interest in his units of the LLC, and only allows this flow until the judgment is satisfied.” *Id.*; *Southlake Equip. Co.*, 2013 OK



CIV APP 87, ¶ 7, 313 P.3d 289. Thus, reverse piercing the corporate veil allows a creditor greater access to the assets of the business entity on the other side of the veil, whereas an LLC charging order allows only a narrower remedy.

The court of appeals stated that the trial court may have been flawed in its analysis, but the appellate court considered whether the trial court was correct in its result. In so doing, the court of appeals considered whether the application of reverse piercing in this case was consistent with Oklahoma law.

In analyzing whether reverse veil piercing in an LLC context is consistent with Oklahoma law, the court pointed out that the Oklahoma LLC statute provides that “rules of law and equity” supplement the LLC statute with regard to any case not addressed in the statute. The court determined that this language allowed the well-recognized practice of piercing the corporate veil to apply to LLCs. The court set forth the following non-exclusive list of factors to be considered by Oklahoma courts in determining whether an LLC is the alter ego of a member: (1) whether the LLC is undercapitalized, (2) whether the LLC is without separate books, (3) whether the LLC’s finances are not kept separate from individual finances, individual obligations are paid by the LLC, or vice versa, and (4) whether the LLC is merely a sham. The court noted that it modified the corporate alter-ego analysis slightly to fit the LLC context with respect to the relevance of corporate formalities. Because members often run LLCs in a very informal manner, the court stated that whether corporate formalities are followed is generally not an applicable consideration in the LLC context. The court emphasized that the most important element in any veil-piercing analysis is control.

The court acknowledged concerns that have been expressed regarding the potential harm to third parties that may result from the application of reverse veil piercing, but the court stated that these concerns may be lessened or eliminated in certain cases, such as where the entity is controlled by a single owner.

The court next discussed Illinois and Colorado case law in which veil piercing has been applied to an equitable owner in the corporate and LLC contexts. The court found the analyses of the Colorado and Illinois courts to be well-reasoned and persuasive and determined that the extension of the equitable ownership doctrine to the veil-piercing analysis was consistent with the principles of fairness and efficiency valued in Oklahoma corporate law.

The court applied the equitable ownership doctrine to the instant case and found that Henson was an equitable owner in both Henson Farms, LLC and Henson Insurance Group, LLC for the following reasons: (1) both LLCs had a sole member who was closely related to Henson (his wife); (2) Henson acted as the companies’ primary decision maker for extended periods of time; and (3) Henson had unfettered discretion in making cash withdrawals for his own personal use. Henson argued that he was merely a manager, but the court did not find this argument persuasive. The court pointed out that the operating agreement of Henson Insurance Group, LLC stated that “the Company shall be managed by its Members” and did not provide for any non-member manager. The court found that Henson’s unchecked control of the two LLCs did not resemble that of a manager, but that of an owner. The court further determined that Henson appeared to use his wife’s name only as a defensive shield against creditors and that his wife was a symbolic figurehead while he carried on the majority of the business.

After concluding that Henson was an equitable owner of the two LLCs, the court applied the veil-piercing factors to determine whether reverse piercing was warranted. The record showed that Henson was insolvent and could not pay his debts, he and his wife failed to maintain separate books and records for the LLCs, and he commingled the LLCs funds with his own personal finances such that the LLC’s bank accounts were used to pay his personal expenses. According to the court, the

evidence as a whole suggested that the LLCs were merely a sham to wrongfully shield Henson's personal assets. Based on these facts, the court of appeals affirmed the trial court and held that the LLCs were Henson's alter egos and that reverse piercing of the corporate veil was supported by the evidence.

As for the charging order, the court of appeals explained that the trial court's order granting a charging order was superfluous in this case. "A charging order allows a judgment creditor to attach only to an LLC member's membership interest, which is personal property distinct from the LLC's assets. 18 O.S. Supp. 2017 §§ 2032, 2034. Because a reverse piercing allows a creditor to attach directly to a business association's assets, treating the business's property as the debtor's property, a charging order against the debtor's capital interest in the company is unnecessary."

***TMX Finance, LLC v. Goldsmith***, 833 S.E.2d 317 (Ga. Ct. App. 2019).

Two ousted members of a Georgia LLC brought a direct action against a third member and several of his entities, alleging that the defendants carried out a takeover scheme by causing a funding crisis. The court of appeals affirmed in part, holding that the ousted members could bring a direct action against the third member and stated claims for breach of the operating agreement, breach of fiduciary duty, fraud, and veil piercing. However, the court reversed in part and held that the third member's alleged breach of fiduciary duties was not a violation of a membership interest purchase agreement.

Dr. Goldsmith, a neurologist who specialized in complex ear procedures, started ICOT Hearing Systems, LLC ("ICOT Hearing") to provide low-cost hearing aids. Jason Jue became involved in the early stages of ICOT Hearing and assisted in building the company into a multimillion-dollar enterprise, running the day-to-day operations as its sole manager. ICOT Hearing was wholly owned by ICOT Holdings, LLC ("ICOT Holdings"). Prior to the events at issue in this case, Goldsmith and Jue together held a majority interest in ICOT Holdings and controlled ICOT Hearing and ICOT Holding (collectively, "ICOT"). Tracy Young founded and controlled the operations of TMX Finance LLC, TitleMax of Texas, Inc., and TitleMax of Georgia, Inc. (collectively, the "TMX Defendants"), which were a "family of companies" consisting of title pawn companies and other businesses.

In August 2015, Young began personally lending money to ICOT. Goldsmith, Jue, and Young shared the goal of selling ICOT to a third party for upwards of "hundreds of millions of dollars in the near term." Young encouraged Jue to "put his foot on the gas" regarding ICOT operations and assured Jue and Goldsmith that he would provide more funding.

In March 2016, ICOT Hearing, ICOT Holdings, Jue, Goldsmith, Young, and Young's limited liability company, TY ICOT Investments ("TY Investments"), entered into a restructuring agreement under which Young loaned additional funds to ICOT Hearing and guaranteed two bank loans (the "Restructuring Agreement"). As part of the restructuring, TY Investments purchased membership units in ICOT Holdings from Goldsmith and minority members and obtained exclusive one-year options to purchase additional units from Goldsmith and minority members. TY Investments' purchase and its options were memorialized in a Membership Interest and Purchase Option Agreement entered at the time of the restructuring of ICOT Holdings (the "Goldsmith Agreement"). As an additional part of the restructuring, ICOT Holdings and its members executed an Amended and Restated Operating Agreement (the "Operating Agreement"), which contained provisions placing certain duties on the company's managers, including the duties to conduct the business in good faith, to not engage in wrongful conduct, and to act in a manner that would not result in improper personal benefit to the managers. The Operating Agreement also provided to TY Investments the power to appoint one of three managers to ICOT Holdings' board of managers. TY

Investments then appointed Young, who agreed to comply with the terms of the Operating Agreement while serving in that position. Following the restructuring and prior to execution of the options, Jue and Goldsmith retained their controlling interest in ICOT Holdings. On the other hand, if TY Investments had executed all of the options it acquired as a result of the restructuring, then Young, through TY Investments, would have a majority interest in ICOT Holdings.

In March 2017, Goldsmith and Jue filed a direct action against Young and TY Investments (collectively, the “Young Defendants”) and against the TMX Defendants. The plaintiffs’ amended complaint included claims for breach of the Operating Agreement, breach of fiduciary duties, breach of the Goldsmith Agreement, fraud, vicarious liability of the TMX Defendants based on the conduct of their personnel, veil piercing, civil conspiracy, and aiding and abetting a breach of fiduciary duty.

The complaint alleged that, after the restructuring, Young orchestrated the following takeover scheme in order to obtain a controlling interest in ICOT Holdings without having to exercise the options: (1) caused an “existential funding crisis” by derailing funding from third-party capital providers; (2) refused to sign the guarantee for a previously negotiated line-of-credit unless he received warrants from Goldsmith and Jue, resulting in short-term cash flow problems; (3) drove away third-party buyer with statements that put the company’s financial health in a poor light, disparaged Jue, and threatened to dilute the membership interests of Goldsmith and Jue; (4) initiated an inspection of ICOT’s books and records in preparation for the takeover; (5) leveraged the funding crisis to control ICOT Holdings’ board of managers by appointing an ally, misrepresenting that ally’s appointment was necessary for ICOT Holdings to draw on the line-of-credit; (6) coordinated vote with the ally to terminate Jue as manager of ICOT Hearing; and (7) diluted Goldsmith and Jue and obtained majority control by issuing a capital call when he knew that the line-of-credit was available and that the plaintiffs lacked the funds to make a pro rata contribution pro rata. After Young took control of ICOT Holdings, he contacted the same third-party buyer and proposed a discounted sale. Considering their diluted position and the discounted sale price, neither Goldsmith nor Jue would receive money from the sale. The defendants answered and later moved to dismiss, contending that the plaintiffs were not entitled to bring a direct claim and had failed to state any viable claims against them. The trial court denied the defendants’ respective motions. The defendants filed applications for interlocutory appeal, which the court granted, leading to the present companion appeals.

One of the issues addressed by the court on appeal was the TMX Defendants’ argument that the plaintiff sought to hold them liable for Young’s alleged misconduct under an outsider reverse veil-piercing theory and that Georgia does not recognize this theory. Although the court agreed with the TMX Defendants that Georgia does not recognize outsider reverse veil piercing (i.e., imposing liability on the entity for a third-party judgment against an owner), it concluded that the plaintiffs stated a claim for veil piercing. The court cited Georgia case law for the proposition that the general purpose of veil piercing is to hold an individual owner liable for the obligations of the entity, but it can also be used to hold a parent company liable for the obligations of a wholly-owned subsidiary or to hold a family of entities liable for the obligations of each other. The court pointed out that the complaint included allegations that the TMX Defendants are a “family of companies” owned and governed solely by Young, that Young controls all operations of the TMX Defendants, that Young used the TMX Defendants for the personal purpose of causing harm to the plaintiffs, and that veil piercing of the TMX Defendants is authorized and appropriate because Young used these “entities to defeat justice, perpetuate fraud, and evade contractual and tort responsibilities.” The court agreed with the TMX Defendants that Georgia law foreclosed any attempt to reach the assets of the TMX Defendants for a judgment debt personally incurred by Young under the theory of outsider reverse veil piercing. However, construed in the light most favorable to the plaintiffs, the amended complaint stated a claim for holding TMX Finance, LLC, liable for any judgment debt incurred by its

subsidiaries, TitleMax Texas, Inc. and TitleMax Georgia, Inc., under a veil-piercing theory, and for holding the TMX “family of companies” liable for any judgment debt incurred by each other under such a theory.

### **Authority of Member or Manager**

*Hardy v. Sagacious Grace, L.C.*, \_\_ P.3d \_\_, 2021 WL 822219 (Utah Ct. App. 2021).

The court held that a real estate purchase contract was unenforceable because the contract was signed by the sole member of a manager-managed LLC, and the member lacked either actual or apparent authority to sign the contract on the LLC’s behalf.

David Hardy operated a business in Springville, Utah. Hardy wanted to expand his business and contacted the adjacent property owner’s attorney. The attorney informed Hardy that Sagacious Grace LC (SG)—a manager-managed LLC—owned the property and that Leslie Mower was SG’s sole member. After several rounds of negotiations, Hardy and Mower executed a sales contract under which Hardy would acquire the adjacent lot for \$150,000. Hardy tendered his \$3,000 earnest money deposit and obtained financing for the purchase. About a month later, the attorney informed Hardy that SG was repudiating the contract. The attorney told Hardy that SG would return the earnest money. Hardy refused to take the earnest money back and sought to proceed with the sale under the contract. Hardy’s lawyer sent SG a letter demanding further assurance that the property contract would close as scheduled later that week. Instead, SG’s attorney responded that, because Mower signed the contract and was not the LLC’s manager (another company controlled by another individual was SG’s manager), he did not believe that the contract was binding on SG.

Hardy sued both SG and Mower for fraudulent misrepresentation, breach of contract, breach of the covenant of good faith and fair dealing, breach of warranty of authority, and constructive trust. Hardy’s fraudulent misrepresentation claim was premised on the theory that SG’s attorney fraudulently misrepresented Mower’s ability to contract on SG’s behalf. Hardy’s other claims stemmed from his assertion that Mower had either actual or apparent authority to bind SG.

SG moved for summary judgment on all claims. The trial court granted SG’s motion for all Hardy’s claims except fraudulent misrepresentation. The court rejected Hardy’s argument that Mower had either the actual or apparent authority to bind SG, and the court thus granted SG’s motion on all claims flowing from the unenforceable contract. The trial court determined, however, that Hardy’s fraudulent misrepresentation theory required a fact-intensive inquiry ill-suited for summary judgment. A bench trial focused on whether SG fraudulently misrepresented Mower’s authority.

Both Mower and Hardy testified at trial. Mower stated that she rarely read documents that her employees provided for her to sign. Further, Mower indicated that she believed at the time that the contract was for a different property she owned in Salem, Utah. Finally, Mower testified that she would not have signed the contract had it identified SG as a party, though she admitted that she had signed documents on SG’s behalf before. For his part, Hardy testified that he did not know at the time that SG was a manager-managed LLC. Following the trial, the trial court dismissed Hardy’s fraudulent misrepresentation claim, determining that Hardy failed to meet his burden of proof. Hardy appealed.

On appeal, Hardy focused his challenge on the trial court’s determination that Mower lacked either actual or apparent authority to bind SG. In particular, Hardy argued that the property sale was outside the usual and ordinary scope of SG’s activities and affairs. As a consequence, Hardy asserted that by executing the sales contract, Mower—SG’s sole member—superseded the requirement that a manager exclusively handle a manager-managed LLC’s affairs.

The court started its analysis with basic Utah limited liability company and agency principles. Utah’s LLC statute provides that for manager-managed LLCs, “any matter relating to the activities and affairs of the limited liability company is decided exclusively by the manager” (Utah Code Ann. § 48-3a-407(3)(a)). Under principles of agency law, agents can only make their principal responsible for their actions if they are acting pursuant to either actual or apparent authority. Mower was not SG’s manager, so the court concluded that she lacked the actual authority required to make SG responsible for her actions. Further, the court determined that Mower lacked apparent authority for two reasons. First, apparent authority must flow from the principal’s conduct. Hardy produced no evidence that SG provided any indication that Mower had authority to act on its behalf. Second, Utah law imposes a duty in a real property transaction to ascertain whether an agent has the authority to enter the contract. As a consequence, SG’s public filings provided Hardy constructive notice that Mower lacked authority to act on SG’s behalf, and notice that an agent lacks authority defeats a claim that the agent had apparent authority.

Next, the court considered Hardy’s argument that the property sale was outside the usual and ordinary scope of SG’s activities and affairs. The court found Hardy’s argument unpersuasive for two reasons. First, Hardy failed to produce sufficient evidence to demonstrate what SG’s ordinary activities and affairs were. The court could not determine that the property sale was unusual when Hardy failed to provide a certificate of organization, operating agreement, or other document that indicated what types of transactions were “usual” for SG. Second, Mower’s testimony that SG had not sold land in the last few years was insufficient to fill Hardy’s production gap. The mere fact that SG had not sold property recently was not enough to allow the court to make a reasonable inference that selling property was unusual for the company.

In sum, the court determined that the district court was correct to grant SG summary judgment because Mower lacked either actual or apparent authority to bind SG, and Hardy failed to produce sufficient evidence that a land sale was not within SG’s ordinary course of business.

### **Fiduciary Duties**

*Straehla v. AL Global Services, LLC*, \_\_\_ S.W.3d \_\_\_, 2020 WL 7364661 (Tex. App.—San Antonio 2020).

The court of appeals held that a Texas LLC alleged its claim for knowing participation in a breach of fiduciary duty with sufficient specificity to survive a motion to dismiss under the Texas Citizens Participation Act.

After Hurricane Maria struck Puerto Rico in September 2017, the Puerto Rico Electric Power Authority hired Cobra Acquisitions LLC (Cobra) to rebuild its utility grid. In turn, Cobra hired AL Global Services, LLC (AL Global) to provide security and logistics support for the project. AL Global subcontracted a portion of its work to Espada Logistics & Security, LLC (Espada Logistics). In August 2018, Cobra ended its contract with AL Global and entered into a contract with Espada Caribbean, LLC (Espada Caribbean) for the work that AL Global had previously performed. AL Global had three members: Jim Jorrie, Craig Charles, and Julian Calderas. The owners of Espada Logistics and Espada Caribbean were Jim Jorrie and his ex-wife, Jennifer Jorrie.

AL Global sued Jim Jorrie for breach of fiduciary duty, alleging that he usurped the company’s business opportunity. Additionally, AL Global sued two Cobra executives, Kinsey and Arty Straehla, asserting that they assisted Jim Jorrie in his misdeeds. Kinsey and Straehla moved to dismiss the case under the Texas Citizens Participation Act (TCPA), arguing that the lawsuit was based on their exercise of free speech and right to association. The trial court denied the motions, and Kinsey and Straehla appealed.

A motion to dismiss under the TCPA triggers a three-step burden shifting mechanism. First, the movant has the burden to show—by a preponderance of the evidence—that the legal action is based on, relates to, or is in response to the movant’s exercise of free speech, association, or petition rights. If the movant meets this burden, the nonmovant has the burden of establishing—by clear and specific evidence—a prima facie case for each essential element of its claim. If the nonmovant meets its burden, the burden shifts back to the movant to establish each essential element of a valid defense to the nonmovant’s claim by a preponderance of the evidence.

Consistent with this framework, the court first determined that Kinsey and Straehla could show that the suit was based on their exercise of the right to free speech. Specifically, AL Global alleged that Kinsey and Straehla actively communicated and generated plans with Jim Jorrie to divert work from AL Global to the Espada companies. The court held that these communications were, at least “tangentially,” on “a matter of public concern” because rebuilding Puerto Rico’s utility system was an issue related to the “environmental, economic, or community well-being” of the island and its residents. Thus, the court next turned to whether AL Global could establish a prima facie case for knowing participation in a breach of fiduciary duty against Kinsey and Straehla by clear and specific evidence (noting that “evidence” for this purpose includes pleadings).

The court outlined the elements of a knowing participation claim as: (1) the existence of a fiduciary duty owed by a third party to the plaintiff; (2) the defendant knew of the fiduciary relationship; and (3) the defendant was aware of his participation in the third party’s breach of its duty. As such, the court recognized that knowing participation in a breach of fiduciary duty is necessarily a derivative claim that requires an underlying breach of fiduciary duty. Thus, AL Global’s claim against Kinsey and Straehla turned on its ability to establish a claim against Jim Jorrie.

The court first observed that the Texas Business Organizations Code does not directly address the duties that a manager or member owes the LLC but contemplates that duties may exist by providing that “[t]he company agreement of a limited liability company may expand or restrict any duties, including fiduciary duties, and related liabilities that a member, manager, officer, or other person has to the company or to a member or manager of the company.” Tex. Bus. Orgs. Code § 101.401. The court noted that it did not have the AL Global LLC agreement in the record, but the court stated that it presumed, “based on the assumption inherent in section 101.401 of the Business Organizations Code that, Jorrie owed the same fiduciary duties that a corporate executive or partner would owe a corporation or partnership, unless the LLC agreement shows otherwise.” Thus, the court concluded that Jorrie “owed a duty of loyalty to [AL Global] and a duty not to usurp corporate opportunities.”

The court then determined that there was ample evidence to establish a prima facie case of breach of a fiduciary duty against Jim Jorrie, describing a sequence of events from the fall of 2017, when AL Global pursued and secured its contract with Cobra, until August 2018, when Cobra entered into a contract with Espada Carribean for the security and logistics work that AL Global had been performing.

As described by the court, the record showed that Jennifer Jorrie began an intimate relationship with Ken Kinsey, a senior Vice President at Cobra, shortly after work on the contract began, and Jim Jorrie appointed Jennifer Jorrie as the project manager for Espada Logistics, a role in which she would work closely with Kinsey. After becoming project manager, Jennifer was assigned to work from Cobra’s headquarters in Puerto Rico at Kinsey’s request. About this time, Jennifer formed Espada Carribean as a Puerto Rican LLC. Jennifer installed Jim Jorrie as CEO of Espada Carribean and assigned him a 67% interest in the company. Although AL Global tasked Jim Jorrie with securing a Puerto Rican security services license for AL Global, Jorrie instead secured

the license for Espada Carribean, which enabled Espada Carribean to legally provide security services in Puerto Rico. In March of 2018, Jorrie attempted to renegotiate AL Global’s subcontract with Espada Logistics in order to increase Espada Logistics’ payment. Charles and Calderas refused, and Jorrie sought to use Jennifer Jorrie’s relationship with Kinsey as leverage, stating in an email to the other AL Global members that Jennifer’s relationship with Kinsey was “immensely valuable” and that, “[w]hether we like the origin or nature of that relationship, it remains undisputed that he is protective of her interests.” Two days later, Jim Jorrie—acting on AL Global’s behalf—executed an amendment to the Cobra contract that provided the agreement would continue after August 15, 2018, only if certain conditions were met. In April, Jorrie continued to press the issue of changing the profit-sharing arrangement between AL Global and Espada Logistics, and Jorrie also informed the other members of AL Global that Jennifer’s relationship with Kinsey had changed and that Kinsey had raped her. After the April meeting of the members, there was evidence that Espada Carribean was negotiating a new contract directly with Cobra. Several communications in July reflected Espada Carribean’s pursuit of a contract directly with Cobra, and AL Global alleged that Jorrie threatened Cobra that if it did not contract directly with the Espada companies, Jennifer Jorrie would publicly allege that Kinsey raped her. When AL Global contacted Cobra in July 2018 to inquire about an extension of the contract, Cobra responded that it was engaged in a Request for Proposal process to evaluate bids, but no process actually occurred, and Cobra never assessed whether contracting directly with Espada Carribean would actually save money. On August 16, 2018, Cobra signed a contract with Espada Carribean to perform the work previously performed by AL Global.

Viewed in a light most favorable to AL Global, the court concluded that this evidence showed that Jorrie placed his own interests ahead of AL Global in order to secure a direct contract between Cobra and Espada Carribean, thus breaching his fiduciary duty of loyalty and usurping AL Global’s business opportunity.

Next, the court turned to whether Kinsey and Straehla were knowing participants in Jorrie’s alleged fiduciary duty breach. The court determined that they were. The court observed that evidence in the record—including two signed contracts—identified Jim Jorrie as an AL Global “Manager.” The court determined that Kinsey and Straehla’s extensive business experience was sufficient to support an inference that they were aware that Jorrie owed AL Global fiduciary duties. As to whether Kinsey and Straehla were knowing participants in Jorrie’s breach of fiduciary duty, the court noted the suspicious circumstances surrounding Cobra’s abrupt pivot from contracting with AL Global to directly dealing with Espada Carribean. The court determined that a reasonable factfinder could infer that this suspicious change was executed to favor Jorrie. As a result, the court determined that AL Global could establish a prima facie case of knowing participation in a breach of fiduciary duty against Kinsey and Straehla.

Finally, the court determined that neither Kinsey nor Straehla had established a defense to AL Global’s prima facie knowing participation case. Thus, the court affirmed the trial court’s decision to deny Kinsey and Straehla’s TCPA motions to dismiss.

***Manere v. Collins***, 241 A.3d 133 (Conn. App. 2020).

The court held that, under Connecticut law, the crucial factor to consider when deciding if the majority has engaged in oppressive conduct justifying court-ordered dissolution is the minority member’s reasonable expectations.

Manere and Collins were high school classmates who both worked in the bar and restaurant industry after graduation. After reconnecting at their thirty-year high school reunion, Manere and Collins formed BAHF, LLC (BAHF) in 2011 to purchase and operate a café in the Fairfield area that

was popular with local college students. They organized BAHR as a manager-managed LLC with both men named as the managers. Both provided initial capital contributions and priority member loans to fund the business's startup. Specifically, Collins provided a \$600 capital contribution and a \$149,400 loan, while Manere provided a \$400 capital contribution and a \$19,600 loan. Collins held a 60% membership interest, and Manere held 40%. At the time, Collins owned and operated a successful bar in New York City and intended to remain in New York; therefore, Manere and Collins agreed that Manere would manage the café's day-to-day operations. The two men agreed to pay Manere a \$600 per week salary. Shortly thereafter, Collins agreed to raise Manere's managerial salary to \$1,000 per week. Unbeknownst to Collins, Manere also used BAHR's funds to pay for his personal expenses, including his health insurance, car payments, and gas.

In 2012, Hurricane Sandy severely damaged the café, and Collins and Manere agreed not to take any guaranteed payments from BAHR for one year while they worked to get the café back on its feet. Manere, however, did not adhere to this agreement, and he used BAHR cash to pay personal expenses, continued drawing a salary, and even unilaterally raised his salary to \$1,500 per week.

In 2015, Collins decided to move back home to Connecticut. Collins decided to open a new restaurant—the Georgetown Saloon—with Manere and two other associates. The saloon proved unsuccessful and closed about one year later, but operating the saloon gave Collins firsthand exposure to Manere's management style. Collins became concerned by what he saw and started to take a more active interest in Manere's handling of the café's finances. Unsurprisingly, Manere resisted Collins's newfound focus and provided incomplete or irrelevant information. Collins persisted and was able to cobble together a rough picture of the café's finances, which revealed that Manere had misappropriated approximately \$190,000.

Collins responded forcefully. First, he unilaterally amended BAHR's operating agreement to terminate Manere as a manager. Next, he fired Manere's son, who was working at the café as a bartender. Finally, Collins removed Manere as one of the café's liquor permittees and changed the café's locks.

After pushing Manere aside, Collins took over direct management of the café, and revenue increased by about 25%. Other than a weekly salary of \$1,000 to Collins, no payments or distributions were made to either Collins or Manere after Collins took over management of the café. Additionally, Collins did not provide Manere any financial information concerning BAHR's finances as required by the operating agreement. In response, Manere sued both Collins and BAHR. In particular, Manere asserted claims for breach of contract against both and claims for breach of fiduciary duty and oppression against Collins. Furthermore, Manere requested that the court dissolve BAHR for oppression. In its response, BAHR counterclaimed against Manere based upon Manere's misappropriation of LLC funds.

After a two-day bench trial, the trial court rendered judgment in favor of Collins and BAHR on all of Manere's asserted claims. The trial court also awarded BAHR over \$190,000 in damages on its counterclaim. Manere appealed on three grounds. First, Manere argued that BAHR's counterclaim failed to state a claim under Connecticut law because misappropriation is not an independent cause of action in Connecticut, and a claim for breach of fiduciary duty must be pled with specificity. Second, Manere argued that the court applied the wrong statute of limitations to BAHR's claim. Finally, Manere asserted that the trial court improperly rejected Manere's application to dissolve BAHR for oppression.

The court concluded that Manere's first point argued mere semantics. Although BAHR never explicitly stated that it was countersuing for breach of fiduciary duty, Connecticut courts are not bound by the labels affixed by the pleading parties when interpreting pleadings. BAHR's pleading sounded in breach of fiduciary duty and alleged facts consistent with a breach-of-fiduciary-duty



cause of action. The pleadings described Manere's role in BAHR and his misappropriation of its assets and income for his personal benefit as well as alleging that Manere, as a member and manager of BAHR, "owed the company the duty to act in good faith towards the company with the care an ordinarily prudent person in a like position would exercise under similar circumstances, and in a manner [he] reasonably believed was in BAHR's best interest, not his personal interest." Accordingly, BAHR's failure to include the phrase "breach of fiduciary duty" in its counterclaim was not prejudicial, and the court found no merit in Manere's claim that BAHR's counterclaim was legally insufficient.

Second, Manere argued that the trial court applied the wrong statute of limitations to BAHR's counterclaim. Because BAHR's counterclaim sounded in tort, Manere argued that Connecticut's three-year statute of limitations should apply. For its part, BAHR responded that its counterclaim sought an accounting, and so the six-year statute of limitations applied by the trial court was correct. The court agreed with Manere. The court first recognized that an action for an accounting generally requires a prior demand by the plaintiff and a refusal by the defendant to account. Here, BAHR never showed that it formally demanded an account from Manere, let alone that Manere refused to account. Indeed, all necessary financial information was available to BAHR by the time that it filed its counterclaim. BAHR was able to successfully prove over \$190,000 in damages. Given that BAHR's counterclaim was not an action for an accounting, the trial court should have applied the three-year statute of limitations applicable to torts. Because there were fact issues relating to the question of whether Manere's tortious conduct fell within the three-year statute of limitations, remand for further proceedings to resolve those fact issues was required.

Finally, Manere asserted that the trial court improperly rejected Manere's application to dissolve BAHR for oppression. The court began its lengthy discussion of the oppression doctrine by noting that the Connecticut Uniform Limited Liability Company Act does not define "oppression" and its legislative history sheds little light on the intended definition. The court thus turned to other extratextual sources of guidance. After describing the history and evolution of the oppression doctrine in the corporate context, the court pointed out that Connecticut substantially adopted the major provisions of the Revised Uniform Limited Liability Company Act. The court thus found it appropriate to look to the RULLCA comments for guidance. Those comments state that, although the Revised Uniform Limited Liability Company Act does not define the term "oppressive," the term is well-grounded in close corporation law.

The court pointed out that the Connecticut Supreme Court recently defined "oppression" as used in the Connecticut Business Corporation Act to encompass both: (1) behavior by the corporation's controller that suggests a lack of probity and a departure from fair dealing; and (2) conduct that substantially defeats the minority shareholder's reasonable expectations. The court recognized, however, that there is an inherent tension between the "fair dealing" and "reasonable expectations" standards. On the one hand, the court noted that the "fair dealing" standard primarily focuses on maintaining the majority's discretion to make decisions that further a legitimate business purpose. Thus, although the majority's decision may impose an outsized negative impact on the minority, a decision will not be oppressive under the "fair dealing" standard if the decision benefits the corporation as a whole. In this regard, the "fair dealing" standard treats close corporations similarly to public companies in that maximizing shareholder value is the ultimate goal. On the other hand, the "reasonable expectations" standard looks at the issue from the minority shareholder's perspective. Under this approach, conduct is oppressive if it substantially defeats the reasonable expectations that a minority shareholder held when he or she decided to join the venture. As a result, the "reasonable expectations" standard pays deference to the fact that the shareholders in close corporations may have expectations that are substantially different than the shareholders in a public

company. In particular, shareholders in close corporations typically expect to actively participate in the management and operations of the enterprise.

The court elected to adopt the “reasonable expectations” approach. First, the RULLCA comments emphasize that in most jurisdictions, “oppression” refers to the frustration of a member’s reasonable expectations, and the guidance provided in the comments for assessing oppression claims is consistent with this view. Furthermore, the court noted that the “reasonable expectations” view is the majority view in the close corporation context because it is more consistent with the nature of a closely held company. The court determined that the considerations that make the “reasonable expectations” approach more appropriate in the corporate context are equally applicable to limited liability companies. Thus, the court held that Connecticut courts should look to the minority member’s reasonable expectations when determining if the majority engaged in oppressive behavior.

Having adopted a new standard, the court felt that it was prudent to elaborate on the contours of the “reasonable expectations” doctrine. First, the court favorably referenced the factors set forth in the RULLCA comments, which include “whether the expectation: (i) contradicts any term of the operating agreement or any reasonable implication of any term of that agreement; (ii) was central to the plaintiff’s decision to become a member of the limited liability company or for a substantial time has been centrally important in the member’s continuing membership; (iii) was known to other members, who expressly or impliedly acquiesced in it; (iv) is consistent with the reasonable expectations of all the members, including expectations pertaining to the plaintiff’s conduct; and (v) is otherwise reasonable under the circumstances.”

Next, the court expressly recognized that employment and involvement in the company’s management are often reasonable expectations of a minority member. Nonetheless, the court also recognized that a member’s reasonable expectations at the inception of an LLC might not remain reasonable over time. In particular, an initially reasonable expectation of continued employment and involvement in management can be vitiated by that member’s misconduct or incompetence. The court also mentioned that a court could find that a minority member’s reasonable expectation has been forfeited if the minority member fails to actively pursue that reasonable expectation. Finally, the court recognized that a causal connection is required between the oppressive conduct and the harm suffered by the plaintiff-member.

With this framework in mind, the court turned to Manere’s assertion that the oppressive conduct of Collins justified dissolving BAHF. Here, the court drew a line between the decision to fire Manere and the other actions taken by Collins (such as suspending member distributions). The court held that a new trial on Manere’s termination of employment was unwarranted because the trial court had already determined that Manere had misappropriated BAHF’s funds. But Manere’s misconduct did not grant Collins and BAHF a license to marginalize Manere in such a way that he was deprived of any remaining reasonable expectations. Although Collins and BAHF were justified in terminating Manere’s employment and depriving him of unfettered access to the café and its bank accounts, Manere was still entitled to realize whatever remaining reasonable expectations he had as a minority member, including a means to share in the company’s profits. Because the trial court did not adequately consider whether Collins and BAHF had defeated Manere’s remaining reasonable expectations, the court determined that a new trial was warranted.

***Plank v. Cherneski***, 231 A.3d 436 (Md. 2020).

The Maryland Court of Appeals answered two certified questions concerning a breach-of-fiduciary-duty claim in Maryland, holding that: (1) a breach of fiduciary duty may be actionable as an independent cause of action and the relief that is available is dependent on the type of fiduciary relationship as well as the historical remedies provided by statute, common law, or by contract; and

(2) a claim for breach of fiduciary duty may be pleaded without limitation as to whether there is another viable cause of action to address the same conduct. The court explained its answer to the certified questions in the context of a dispute between the members of a Maryland LLC. In affirming the trial court’s judgment, the court also held that: managing members of an LLC owe fiduciary duties to the LLC and the other members based on common-law agency principles; the trial court did not deny a claim for breach of fiduciary duty based on an erroneous legal conclusion that no independent cause of action existed; and there was sufficient evidence to conclude that the majority member-officer did not breach his fiduciary duty.

James Cherneski was a former professional soccer player who invented and patented a non-slip athletic sock. In April 2011, Cherneski and investors Sanford Fisher and Jeff Ring formed Trusox, LLC to produce and sell the patented sock. Later, in October 2013, William H. Plank, II invested \$1.5 million in the LLC and acquired a 20% membership interest, with Cherneski owning a 65% membership interest, and Fisher and Ring each owning a 7.5% membership interest. The members of Trusox, along with Trusox, by Cherneski as its CEO and President, entered into an amended and restated operating agreement (the “Operating Agreement”). The Operating Agreement gave Cherneski, as the majority member, President, and CEO, general authority over most decisions relating to Trusox and its operations. Although the company did have some success, it also struggled with cash flow and production issues. In late 2015, Plank and Fisher (collectively, the “Minority Members”) were disenchanted with Cherneski’s leadership of Trusox.

In June 2016, the Minority Members filed an action against Cherneski and Trusox, asserting several claims that included breach of fiduciary duty. The Minority Members sought equitable relief on their claim for breach of fiduciary duty and attorneys’ fees under the Operating Agreement’s fee-shifting provision. At the heart of the Minority Members’ claim for breach of fiduciary duty was their allegation that Cherneski placed their investments at risk by engaging in unlawful actions that exposed Trusox to potential future damages claims for regulatory violations and lawsuits. After a bench trial, the trial court entered judgment in favor of Cherneski on the breach-of-fiduciary-duty claim based on its finding that there was insufficient evidence while noting that “there seem[s] to be ... no stand-alone tort for breach of fiduciary duty” under Maryland case law. The trial court also entered judgment in favor of Cherneski and Trusox against the Minority Members, jointly and severally, for attorney’s fees under the Operating Agreement. The Minority Members appealed, and the appellate court subsequently certified the following questions to the Maryland Court of Appeals: (1) May minority members of an LLC (a) bring a stand-alone cause of action for breach of fiduciary duty against the managing member of the LLC (b) premised on allegations that the managing member was engaged in unlawful actions that placed at risk the investments of the minority members? (2) If so, is such a claim (a) limited to allegations that would also support another viable cause of action, (b) limited to allegations that would not also support another viable cause of action, or (c) not limited by whether or not there is another viable cause of action to address the same conduct?

The court addressed the certified questions first before considering the trial court’s disposition of the Minority Members’ breach-of-fiduciary-duty claim and the attorneys’ fee dispute. Although these were the only matters at issue on appeal, most of the court’s discussion focused on the breach-of-fiduciary-duty claim. The court provided an overview of traditional LLC principles as codified in the Maryland Limited Liability Company Act (the “Maryland LLC Act”) because Trusox was a Maryland LLC and the statute, together with the Operating Agreement, created the legal obligations and duties relevant here. Because the Operating Agreement and the Maryland LLC Act were silent with respect to any fiduciary duties that Cherneski, as the majority member, President, and CEO, owed to the Minority Members, the court stated that it would look to whether

a fiduciary relationship existed under common law. As a matter of first impression for the court, it held that managing members of an LLC owe fiduciary duties to the LLC and to the other members based on common-law agency principles. Although the court agreed with an appellate court that the language of the Maryland LLC Act suggests that an operating agreement “could alter existing duties,” the court concluded that there were no limitations in Trusox’s Operating Agreement that would alter the fiduciary duties arising from the agency relationship.

The Maryland Court of Appeals continued with an extensive review of breach-of-fiduciary-duty case law in Maryland, beginning with its seminal case, *Kann v. Kann*, 690 A.2d 509 (Md. 1997). This review included the court’s cases involving breach-of-fiduciary-duty claims post-*Kann*, cases in Maryland appellate courts interpreting *Kann*, discussion of *Kann* in the federal courts, and other discussions on Maryland’s jurisprudence relating to breach-of-fiduciary-duty claims. In *Kann*, the court’s holding “that there is no universal or omnibus tort for the redress of breach of fiduciary duty by any and all fiduciaries” was followed by a passage identifying four factors for analysis that other courts and litigants were to follow on a case-by-case basis when considering whether a party could assert a claim involving a breach of fiduciary duty. These *Kann* factors are discussed below. The court lamented that the *Kann* holding has been over-simplified into a blanket assertion that “Maryland does not recognize a separate tort for breach of fiduciary duty,” though it acknowledged its part in this over-simplification with seemingly contradictory footnotes in two post-*Kann* cases. The court noted that differing interpretations of *Kann* have led to a “muddled state” of jurisprudence with inconsistent results in state and federal courts. The court resolved the contradiction by concluding that those footnotes were dicta and clarified its *Kann* holding by answering the certified questions.

The court answered the first certified question in the affirmative, holding that, under *Kann* and its jurisprudence that followed, a breach of fiduciary duty may be actionable as an independent cause of action and the relief that is available will be determined by the type of fiduciary relationship as well as the historical remedies provided by statute, common law, or contract. The court observed that fiduciary relationships can be created in different ways and can have distinct characteristics, such as trustees and beneficiaries, agents and principals, and lawyers and clients. The court explained that, although a fiduciary will have general responsibilities common to all settings, such as the duty of loyalty, they will also have specific obligations that depend on the particular fiduciary relationship. The court offered as examples that the obligations of a trustee are defined by the law of trusts, the obligations of an agent are defined by the law of agency, and the obligations of fiduciaries in many settings are further specified by statute. The court further explained that there is no “one-size fits all” breach-of-fiduciary tort encompassing all types of relationships and that this was the essence of its holding in *Kann*. In addition to reciting the elements to establish a breach of fiduciary duty as an independent cause of action, the court provided the four factors under its *Kann* analysis to consider on a case-by-case basis as follows: (i) identify the particular fiduciary relationship involved; (ii) identify how it was breached; (iii) consider the remedies available; and (iv) select the appropriate remedies. The court also answered the second certified question in the affirmative, holding that the claim may be pleaded without limitation as to whether there is another viable cause of action to address the same conduct.

Next, the Maryland Court of Appeals turned to the trial court’s disposition of the Minority Members’ breach-of-fiduciary-duty claim. The Minority Members contended that the trial court erred by concluding that under *Kann*, no independent claim exists and, even if the trial court considered the claim, it erred by finding that there was insufficient evidence to show that Cherneski breached his fiduciary duties. The court disagreed, holding that the trial court did not deny the breach-of-fiduciary-duty claim based on an erroneous legal conclusion that no cause of action existed and that

the evidence was sufficient to conclude that Cherneski did not breach his fiduciary duty. The court determined that the trial court considered the Minority Members' breach-of-fiduciary-duty claim on its merits and entered judgment in favor of Cherneski after making a factual determination that there had been no breach of fiduciary duty. The court observed that this was the last matter addressed by the trial court after having disposed of all other claims and, based on a review of the record, it was clear that the trial court considered all of the testimony and evidence in support of its finding that there was insufficient evidence of a breach. The court pointed out that it was significant that the trial court did not state that it was entering judgment in Cherneski's favor because it thought that no cause of action existed.

*Wilson v. Gandis*, 844 S.E.2d 631 (S.C. 2020).

The South Carolina Supreme Court affirmed the trial court's finding that two members owning 55% of the membership of an LLC oppressed the remaining member pursuant to a "tightly controlled cabal to oust [the minority member] that could serve as a script for minority oppression." The court rejected the majority members' argument that they were protected from personal liability for their actions by the South Carolina LLC statute, but held that the majority members would only be required to perform the equitable remedy of a buyout of the minority member's interest if the LLC failed to do so. Further, the court held that the members of the majority faction (a 45% member and a 10% member) should only be liable for their proportional shares of the buyout price rather than having joint and several liability. The court held that the majority lacked standing to bring their claims against the minority member for breach of fiduciary duty because they asserted the claims individually rather than derivatively, and the evidence did not show that information used by the minority member and his subsequent employers constituted trade secrets of the LLC.

David Wilson, John Gandis, and Andrea Comeau-Shirley were members of Carolina Custom Converting, LLC (CCC). CCC was formed by Gandis and Wilson in 2007 as a manager-managed LLC with each owning a 50% membership interest. Gandis served as president and manager, and Wilson served as vice-president. No formal operating agreement was ever executed for CCC, but Wilson and Gandis memorialized many of their oral agreements through emails and a questionnaire they completed with the intent to create an operating agreement. Neither signed noncompete, nondisclosure, or non-solicitation of employee(s) agreements. When CCC was formed, Wilson owned and operated Eastern Film Solutions (EFS), which bought and sold synthetic and metalized films. Gandis owned and operated DecoTex, which bought and sold decorative designs for vinyl film. Wilson and Gandis initially agreed that CCC would perforate and slit film. Wilson agreed to run some of EFS's slitting business through CCC.

In 2008, Wilson and Gandis discussed winding down their individual businesses and expanding CCC's operation. Wilson agreed that CCC would become a buyer and seller of film for one of EFS's major accounts, which would result in significant additional revenue for CCC. Additional discussions between Gandis and Wilson regarding Wilson's winding down EFS and running all future film business through CCC occurred throughout 2008. Wilson advised Gandis that Wilson intended to keep three import accounts separate from CCC. In exchange for transferring EFS's accounts to CCC, Wilson received \$8,000 (later increased to \$12,000) per month. After the expansion of CCC, Gandis managed operations and Wilson led CCC's sales efforts. Wilson completed the winding down process of EFS in 2009. Gandis continued to own and operate his own decorative design vinyl business DecoTex. Gandis agreed to fund CCC through credit lines from DecoTex and his other business M-Tech. CCC also operated out of a building owned by M-Tech, for which Gandis received the benefit of rent payments made by CCC.

In 2008, Gandis engaged Shirley, a CPA, to provide CCC with accounting and formation advice. In 2009, Gandis and Wilson each transferred a 5% interest in CCC to Shirley in exchange for her services. Shirley did not have a formal voting interest, but she took an active role in managing CCC and provided extensive personal counsel to Gandis about his operation of CCC.

CCC's business grew, and CCC posted a profit of over \$1,000,000 in 2010. From the time CCC was formed in 2007 through 2010, CCC reserved funds for the members to cover their individual tax liabilities. Although CCC had an operating loss in 2011, the high profits from 2010 combined with excess inventory created phantom income for the members, and the leaner revenue from 2011 resulted in a shortfall for the planned 2010 tax distributions. The court described private email exchanges between Gandis and Shirley in early 2011 in which Shirley urged Gandis to use funds set aside by CCC for its members' 2010 tax liability to pay off CCC's obligation on the M-Tech line of credit rather than distributing the funds to cover their income tax liability as had been the customary practice. In one email to Gandis, Shirley stated, "What I want to do is to keep the cash balance [of CCC] relatively low ... so we don't get a request around tax time [from Wilson] to 'distribute' any extra money ... instead ... it will already have been used to repay debt. Which is a better use!" She advised Gandis to use the M-Tech line of credit to pay his own taxes, which Gandis did, and Shirley told Wilson by email on April 15, 2011, that no distributions would be made to CCC members to cover tax liability. Shirley and Gandis also began secretly monitoring Wilson's emails, and trial testimony and emails between Shirley and Gandis revealed their plans to take various actions calculated to benefit Gandis and Shirley and disadvantage Wilson with the ultimate goal of excluding Wilson from the business.

The trial court summarized the following oppressive and unfairly prejudicial acts of Gandis and Shirley from 2010-2012: (1) initiating an "exit strategy" for Wilson; (2) threatening to stop Wilson's agreed-upon and guaranteed monthly payments unless he relinquished his membership interest and became an at-will employee with a noncompete agreement; (3) refusing to make a tax distribution to Wilson while setting aside the funds for a distribution to pay off a line of credit so Gandis could borrow against that line to pay his own taxes; (4) monitoring all of Wilson's private emails, including those with his wife, his attorney, and his accountant; (5) withholding Wilson's agreed-upon and guaranteed monthly distributions in January 2012; (6) making representations that Wilson may not receive distributions for two years; (7) managing the money supply to make it appear as if cash was more limited than it was in actuality; (8) continually making unilateral changes, including secretly back-paying rent at a higher rate than agreed upon and transferring assets, e.g., an air conditioner, to Gandis's entities by expensing such items as rent; (9) limiting Wilson's access to CCC's financial information; (10) removing Wilson from signatory authority on CCC's operating account; (11) removing Wilson's ability to make wire transfers for CCC; (12) excluding Wilson from discussions about CCC's business operations; (13) manipulating the December 2011 "Pro-Forma Balance Sheet" to devalue Wilson's interest in CCC; (14) physically locking Wilson out of his company and refusing to allow him to return; (15) demanding possession of Wilson's laptops and Blackberry; (16) terminating the cell phone plans for Wilson and his family while maintaining coverage for the other members; (17) terminating health insurance coverage for Wilson and his family; and (18) forming a company to compete with CCC in order to siphon profits until Wilson caught them.

Wilson filed suit against Gandis and Shirley in 2012 alleging several causes of action. Wilson later sued CCC, and CCC sued Wilson and his subsequent employers. Pertinent to this appeal were Wilson's claim against Gandis and Shirley for minority member oppression, Gandis's and Shirley's counterclaim against Wilson for breach of fiduciary duty, and CCC's claims for misappropriation of trade secrets.

The Supreme Court of South Carolina began its discussion of minority member oppression by noting that the South Carolina Uniform Limited Liability Company Act provides that “[a] member or manager may maintain an action against a limited liability company or another member or manager for legal or equitable relief” to enforce the member’s statutory rights under the Uniform Limited Liability Company Act of 1996 (the LLC Act), the member’s rights under an operating agreement, and “the rights that otherwise protect the interests of the member.” S.C. Code Ann. § 33-44-410(a). The comment to that section provides that there is “broad judicial discretion to fashion appropriate legal remedies.” If a member establishes that “the managers or members in control of the company have acted, are acting, or will act in a manner that is unlawful, oppressive, fraudulent, or unfairly prejudicial” to the member, a court may dissolve the limited liability company. S.C. Code Ann. § 33-44-801(4)(e). The comment to that section provides “the court has the discretion to order relief other than the dissolution of the company... includ[ing] ... the purchase of the distributional interest of the applicant.” S.C. Code Ann. § 33-44-801 cmt. The court cited and discussed minority shareholder oppression cases involving closely held corporations and stated that the considerations in those cases also apply to a claim for oppression made by a minority member of an LLC.

The supreme court agreed with the trial court’s characterization of Gandis’s and Shirley’s efforts as a “tightly controlled cabal to oust Mr. Wilson [that] could serve as a script for minority [ ] oppression.” The court said that the record was replete with evidence of “freeze out” maneuvers on the part of Gandis and Shirley. The emails revealed a calculated, step-by-step scheme to oust Wilson and relegate him to either a former owner or an employee bound by a noncompete agreement. Shirley even stated to Gandis “we will freeze his capital account and provide that he will be paid out ONLY when the LLC has made distributions to you in excess of your guaranteed payment (and your tax liability),” and that “might mean that [Wilson] sits with a frozen capital account until the LLC liquidates (and he will still have a 2010 tax bill that he has to pay).”

Gandis and Shirley argued that the court erred in determining that they oppressed Wilson because of Wilson’s “unclean hands” and that their actions were not oppressive because they were not motivated to shut Wilson out, but to provide Wilson with options to remain a member of CCC while satisfying his tax liability. The court rejected these arguments and stated that the evidence in the record showed to the contrary. The court also rejected Gandis’s and Shirley’s argument that their actions were protected by the business judgment rule because the rule only applies “absent a showing of a lack of good faith, fraud, self-dealing or unconscionable conduct.” The court agreed completely with the trial court’s conclusion that “[t]he record—particularly the remarkable emails between Gandis and Shirley—abounds with evidence of calculated oppression.”

The court then addressed Gandis’s and Shirley’s argument that the trial court took an extreme and legally unsupported step by holding them personally liable for the alleged oppression of Wilson. Gandis and Shirley contended that the LLC Act protects members from personal liability taken in the ordinary course of business. The court agreed that the LLC Act typically provides personal liability protection, but the court rejected the argument that an LLC member who commits acts of “calculated oppression” against another member has acted in the ordinary course of business of the LLC.

The court granted Gandis and Shirley partial relief by ordering that CCC was primarily responsible for purchasing Wilson’s interest and that Gandis and Shirley were only personally obligated to buy out Wilson’s interest if CCC failed to do so. The court also held that Shirley and Gandis should not be jointly and severally liable for the entire purchase price. Shirley argued, and Gandis agreed, that Shirley’s responsibility to purchase any portion of Wilson’s interest should be limited to the proportion her interest in CCC bears to the entire obligation to purchase. The court agreed but stated in a footnote that it was not foreclosing the possibility that an LLC member who

acts to oppress another member can be held liable for an amount greater than his or her proportional interest in the LLC.

The court briefly discussed the claim of Gandis and Shirley against Wilson for breach of fiduciary duty. Gandis and Shirley alleged in their counterclaim that Wilson breached fiduciary duties owed to CCC and to them by (1) usurping CCC's business opportunities with customers from EFS and engaging in secretive side deals; (2) misappropriating CCC's alleged trade secrets and confidential information; and (3) destroying evidence on CCC's laptops and Blackberry. Because CCC would have sustained any financial loss caused by Wilson's alleged actions, the court held that Gandis and Shirley lacked standing to bring a breach-of-fiduciary-duty claim in their individual capacities. On the merits, the court found that the trial court correctly concluded Wilson did not breach any fiduciary duties owed to Gandis and Shirley.

The court next addressed the valuation of Wilson's distributional interest in CCC and the date of valuation. Gandis and Shirley argued that an incorrect method of valuation was applied and resulted in a windfall for Wilson. The court rejected this argument, relying on S.C. Code Ann. 33-44-701(e), which provides the mechanism for determining fair value of a member's distributional interest when it is being purchased by the company. The court held that the same approach should be applied when individual members are ordered to buy the distributional interest. As for the date of valuation, the court noted that there is little authority regarding the appropriate date for valuation, but the court cited case law stating that the date of ouster seems to be an appropriate date for valuation in cases of minority shareholder oppression. Wilson's expert valued CCC's total equity at \$1,018,753 and Wilson's interest at \$408,335 as of December 31, 2011. She valued Wilson's interest at \$233,776 as of December 31, 2013. The trial court's appointed expert and the defendants' expert testified of possible adjustments to the value of CCC due to equipment moving costs, excess inventory, and advances. The trial court noted that CCC, Gandis, and Shirley failed to present evidence of CCC's then-current financial condition at the time of trial. The court found the December 31, 2011 valuation of Wilson's expert credible but applied the three downward adjustments of the defendants' expert to calculate the value of Wilson's interest as of that date. The supreme court agreed with the trial court's valuation, holding that the most equitable valuation date was December 31, 2011 for several reasons. First, as noted by the trial court, CCC, Gandis, and Shirley failed to present evidence of CCC's then-current financial condition during the 2014 trial, partly because CCC failed to file tax returns for the 2012 and 2013 tax years. Second, Gandis and Shirley initiated an exit strategy and ousted Wilson in January 2012. Thus, valuing CCC and Wilson's interest in CCC as of December 31, 2011, provided an accurate value of CCC when Wilson was an active member of CCC with an opportunity to impact CCC's financial condition. On the other hand, the court stated that December 31, 2013, was an inappropriate valuation date because Gandis and Shirley ousted Wilson in January 2012 and prevented Wilson from participating in any CCC business decisions or operations that impacted CCC's value after January 2012.

Finally, the court addressed CCC's claim that Wilson and his subsequent employers misappropriated CCC's trade secrets. CCC claimed that it spent significant time and resources developing its customer and supplier contact lists, electronic vendor reference program, and inventory reference program, and that all of this information was CCC trade secrets. The court agreed with the trial court's determination that the information CCC claimed as trade secrets lacked independent economic value. Without independent economic value there can be no trade secret, and CCC's claim for misappropriation failed.



*Homapour v. Harounian*, 182 A.D.3d 426 (N.Y. App. Div. 1st 2020).

The appellate court affirmed as modified the trial court's order that dismissed certain derivative claims against a member, one group of LLCs, and counsel representing another group of LLCs. In modifying that order, the court held as follows: (1) a six-year statute of limitations governed the derivative claims for breach of fiduciary duty and waste against the member; (2) the "open repudiation" doctrine tolled any limitations period applicable to those derivative claims against the member; (3) the trial court erred in dismissing the derivative claim for a constructive trust against the member and one group of LLCs; (4) the plaintiff-member adequately stated derivative claims for breach of fiduciary duty as well as aiding and abetting breach of fiduciary duty against counsel for the other group of LLCs; (5) a six-year statute of limitations governed the derivative claims against counsel; and (6) the continuous representation doctrine did not toll the limitations period for the derivative claims against counsel.

Mehrnaz Nancy Homapour, her brother and defendant Mark Harounian, and other family members formed sixteen LLCs (the "Family LLCs"). Homapour brought this action against Harounian, the Family LLCs, several LLCs presumably under Harounian's control (the "Harounian LLCs"), and counsel representing the Family LLCs, asserting multiple derivative claims on behalf of the Family LLCs. Harounian, the Family LLCs, and the Harounian LLCs filed a motion to dismiss the derivative claims for breach of fiduciary duty and waste against Harounian as barred by a three-year statute of limitations. They also sought dismissal of the derivative claim for a constructive trust against Harounian and the Harounian LLCs as well as dismissal of part of the derivative unjust enrichment claim that sought a declaration as to the Family LLCs' interest in real estate that Harounian purchased. Counsel for the Family LLCs also filed a motion to dismiss the derivative claims for breach of fiduciary duty as well as aiding and abetting breach of fiduciary duty as barred by a three-year statute of limitations. After the trial court granted both motions, Homapour appealed.

The appellate court held that a six-year statute of limitations applied to the derivative claims for breach of fiduciary duty and waste against Harounian for two reasons, each supported by New York case law. First, the court concluded that, while these claims were not fraud-based, Homapour did seek both money damages and equitable relief, "i.e., a constructive trust, an injunction, and an accounting." Second, the court stated that derivative claims are governed by a six-year limitations period because they are "equitable in nature." The appellate court also held that "[i]n any event, the 'open repudiation' doctrine applies to toll any applicable statute of limitations, because Harounian continues to be in a fiduciary relationship with the Family LLCs."

Next, the court concluded that the trial court erred in dismissing the derivative claim for a constructive trust against Harounian and the Harounian LLCs. The court again cited New York case law for the proposition that a constructive trust is an equitable remedy and its purpose is to prevent unjust enrichment. The court determined that the complaint sufficiently alleged that Harounian misappropriated the Family LLCs' funds to acquire real property for his own personal benefit, which was purportedly owned by the Harounian LLCs. The appellate court also concluded that the trial court correctly dismissed the part of the derivative unjust enrichment claim seeking a declaration that "the Family LLCs are entitled to a pro rate ownership interest in the real estate that Harounian purchased" under New York's statute of frauds.

Finally, the appellate court held that Homapour adequately stated derivative claims for breach of fiduciary duty as well as aiding and abetting breach of fiduciary duty and that these claims were governed by a six-year statute of limitations. The court reasoned that the complaint stated a claim for breach of fiduciary duties because Homapour alleged that counsel, while retained by the Family LLCs, began acting as attorney for Harounian personally without disclosure to the Family LLCs and inserted unilateral changes into operating agreements that favored Harounian's personal interests

over those of the Family LLCs. Similarly, the court found that Homapour stated a claim for aiding and abetting breach of fiduciary duty by alleging that counsel for the Family LLCs assisted Harounian in making those unilateral changes to the operating agreements and appended Homapour's signature pages to the altered agreements as part of Harounian's scheme to misappropriate funds from the Family LLCs. The court concluded that the six-year limitation period applied to the derivative claims against counsel for the Family LLCs for the same reasons it applied to the derivative claims against Harounian, i.e., although the claims were not fraud-based, Homapour sought both money damages as well as equitable relief and the claims were derivative. The appellate court further held, however, that Homapour's reliance on the continuous representation doctrine in arguing for a global tolling of the statute of limitations was misplaced because each Family LLC was a discrete client.

***Bonanni v. Horizons Investors Corp.***, 179 A.D.3d 995 (N.Y. App. Div. 2d 2020).

The appellate court affirmed the trial court's judgment in favor of an ousted 20% LLC member on direct and derivative claims brought by the ousted member. The appellate court held that the ousted member was entitled to an accounting from a successor LLC based on the defacto merger doctrine even though the original LLC was not formally dissolved; the business judgment rule did not protect the defendants from liability for their decision to "effectively cancel or seize" the ousted member's interest in the LLC; the individual sole owner of a corporation that was a 40% member of the LLC was personally liable for damages based on veil-piercing grounds where the individual manipulated and dominated the LLC in a manner that resulted in wrongdoing injuring the ousted member; the 40% member and its individual owner were properly held jointly and severally liable for all of the damages suffered by the LLC on the tort theories of liability forming the basis of the derivative claims, but proportional responsibility for damages was appropriate with respect to the damages suffered by the ousted member based on the deprivation of distributions since those theories were primarily contractual in nature.

In 2001, MRI Enterprises, LLC ("MRI LLC") was formed by Luciano Bonanni, acting through his wholly owned corporation, MRI Enterprises, Inc. ("MRI Inc."), Benito Fernandez, acting through his wholly owned corporation, Horizons Investors Corp. ("Horizons"), Solomon Kalish, acting through his wholly owned corporation, Adex Management Corp. ("Adex"), and Allan Hausknecht, a physician. MRI LLC's purpose was to provide MRI services to local hospitals. MRI Inc., Adex, and Hausknecht each held a 20% interest in MRI LLC, and Horizons held the other 40%. Because nonphysicians are not permitted to provide medical services, the members of MRI LLC also formed Comprehensive Imaging of New York, PLLC ("CINY"), of which Hausknecht owned 99% and another physician owned 1%, to provide the medical services to the hospitals.

In 2005, a dispute arose amongst the members of MRI LLC regarding which MRI scanners should be purchased for a client hospital. Bonanni managed day-to-day operations of MRI LLC and was excluded from management of MRI LLC after a particularly contentious meeting. Kalish took over Bonanni's duties, and the members discussed the respective rights and duties of Bonanni/MRI Inc. and the remaining members, but the remaining members never acquired MRI Inc's interest in MRI LLC. They also failed to include MRI Inc. in any future distributions.

Bonanni then commenced an action seeking an accounting and asserting claims for breach of contract, conversion, breach of fiduciary duty, and unjust enrichment. As a member of MRI LLC, Bonanni also asserted derivative claims of misappropriation of corporate opportunities, looting, waste, and misappropriation of assets. The trial court found that Bonanni may have resigned as MRI LLC's manager but did not withdraw his membership and that the response of the other members of MRI LLC was to freeze out Bonanni/MRI Inc. rather than compensate MRI Inc. for its interest

in MRI LLC. The trial court also found that the defendants had engaged in self dealing and other misconduct in regard to the derivative claims. Finally, the trial court held that MRI Inc., as a member of MRI LLC, was entitled to an accounting of certain payments made by or for MRI LLC and CINY. The trial court entered judgment for damages in favor of MRI Inc. and MRI LLC and directed the defendants to provide MRI Inc. an accounting of certain payments made by or for MRI LLC and CINY. Fernandez and Horizons (Fernandez's corporation that was the 40% member of MRI LLC) appealed.

After concluding that MRI Inc. was entitled to an accounting from CINY as a successor in a de facto merger of MRI LLC with CINY, the court discussed the defendants' argument that the business judgment rule precluded the plaintiffs' causes of action. The court recognized that, pursuant to the business judgment rule, courts will defer to the unbiased, good-faith determinations of corporate officers that certain actions will promote the corporation's best interest. The court explained that the plaintiffs did not object to the business decision made in 2005 to exclude Bonanni from management of MRI LLC in light of their disagreements. Instead, Bonanni/MRI Inc. only sought to recover distributions to which MRI Inc. remained entitled since its membership interest in MRI LLC was not withdrawn or acquired. The court rejected the defendant's invocation of the business judgment rule because the decision to effectively cancel or seize MRI Inc.'s 20% interest made after Bonanni had ceased management of MRI LLC could not be characterized as a good-faith decision made in the best interest of MRI LLC.

The appellate court next concluded that the evidence supported the trial court's finding that certain payments made to a company controlled by Fernandez were actually disguised profit distributions by MRI LLC to Fernandez.

The court next addressed Fernandez's contention that he should not have been held personally liable for the damages awarded against Horizons, much less for the entire amount of damages awarded to MRI LLC, because the owners of a corporation are not personally liable for the obligations of the corporation. The court stated that to pierce the corporate veil a plaintiff must show that (1) the owners exercised complete domination of the corporation in respect to the transaction attacked and (2) that such domination was used to commit a fraud or wrong against the plaintiff resulting in the plaintiff's injury. The court listed factors commonly examined in a veil-piercing analysis and concluded that the record showed as a whole that Fernandez exercised complete domination of MRI LLC and did so in a manner that resulted in a fraud or wrong injuring MRI Inc. The plaintiffs' forensic accountant identified numerous suspicious or unusual financial transactions as well as "a specific transaction in which it appeared that Fernandez was 'trying to manipulate the books' to hide a transaction, and another series of transactions that appeared to be a liquidation of an account which held approximately \$220,000 but which excluded MRI Inc. from the distribution." Furthermore, the court characterized "the seizure of MRI Inc.'s 20% interest in MRI LLC with no process and no payment to MRI Inc." as a "failure to adhere to corporate formalities," and the court stated that "the manipulation of transactions between MRI LLC and CINY resulted in a 'commingling of assets' and/or the 'use of corporate funds for personal use.'"

With regard to the trial court's imposition of joint and several liability on Fernandez, the court concluded: "Since we agree with the Supreme Court's determination to pierce MRI LLC's corporate veil to hold Fernandez personally liable, we agree with the court's determination to impose joint and several liability against [Fernandez and Horizons] with respect to the damages award in favor of MRI LLC on the tort theories of looting, waste, and misappropriation of assets and corporate opportunities." However, the appellate court also agreed with the trial court's determination not to impose joint and several liability against Fernandez for the entire damages award in favor of MRI Inc. The appellate court agreed with the trial court's decision to impose liability for MRI Inc.'s share

of distributions by MRI LLC in proportion to the interests of the remaining members (i.e., Fernandez and Horizons were held liable for 50%, Adex and Kalish for 25%, and Hausknecht for 25%) because the trial court was able to determine the proportions in which the defendants profited from the seizure of MRI Inc.'s share in MRI LLC, and the theories under which MRI Inc. recovered against them were primarily contractual in nature.

***TMX Finance, LLC v. Goldsmith***, 833 S.E.2d 317 (Ga. Ct. App. 2019).

Two ousted members of a Georgia LLC brought a direct action against a third member and several of his entities, alleging that the defendants carried out a takeover scheme by causing a funding crisis. The court of appeals affirmed in part, holding that the ousted members could bring a direct action against the third member and stated claims for breach of the operating agreement, breach of fiduciary duty, fraud, and veil piercing. However, the court reversed in part and held that the third member's alleged breach of fiduciary duties was not a violation of a membership interest purchase agreement.

Dr. Goldsmith, a neurologist who specialized in complex ear procedures, started ICOT Hearing Systems, LLC ("ICOT Hearing") to provide low-cost hearing aids. Jason Jue became involved in the early stages of ICOT Hearing and assisted in building the company into a multimillion-dollar enterprise, running the day-to-day operations as its sole manager. ICOT Hearing was wholly owned by ICOT Holdings, LLC ("ICOT Holdings"). Prior to the events at issue in this case, Goldsmith and Jue together held a majority interest in ICOT Holdings and controlled ICOT Hearing and ICOT Holding (collectively, "ICOT"). Tracy Young founded and controlled the operations of TMX Finance LLC, TitleMax of Texas, Inc., and TitleMax of Georgia, Inc. (collectively, the "TMX Defendants"), which were a "family of companies" consisting of title pawn companies and other businesses.

In August 2015, Young began personally lending money to ICOT. Goldsmith, Jue, and Young shared the goal of selling ICOT to a third party for upwards of "hundreds of millions of dollars in the near term." Young encouraged Jue to "put his foot on the gas" regarding ICOT operations and assured Jue and Goldsmith that he would provide more funding.

In March 2016, ICOT Hearing, ICOT Holdings, Jue, Goldsmith, Young, and Young's limited liability company, TY ICOT Investments ("TY Investments"), entered into a restructuring agreement under which Young loaned additional funds to ICOT Hearing and guaranteed two bank loans (the "Restructuring Agreement"). As part of the restructuring, TY Investments purchased membership units in ICOT Holdings from Goldsmith and minority members and obtained exclusive one-year options to purchase additional units from Goldsmith and minority members. TY Investments' purchase and its options were memorialized in a Membership Interest and Purchase Option Agreement entered at the time of the restructuring of ICOT Holdings (the "Goldsmith Agreement"). As an additional part of the restructuring, ICOT Holdings and its members executed an Amended and Restated Operating Agreement (the "Operating Agreement"), which contained provisions placing certain duties on the company's managers, including the duties to conduct the business in good faith, to not engage in wrongful conduct, and to act in a manner that would not result in improper personal benefit to the managers. The Operating Agreement also provided to TY Investments the power to appoint one of three managers to ICOT Holdings' board of managers. TY Investments then appointed Young, who agreed to comply with the terms of the Operating Agreement while serving in that position. Following the restructuring and prior to execution of the options, Jue and Goldsmith retained their controlling interest in ICOT Holdings. On the other hand, if TY Investments had executed all of the options it acquired as a result of the restructuring, then Young, through TY Investments, would have a majority interest in ICOT Holdings.

In March 2017, Goldsmith and Jue filed a direct action against Young and TY Investments (collectively, the “Young Defendants”) and against the TMX Defendants. The plaintiffs’ amended complaint included claims for breach of the Operating Agreement, breach of fiduciary duties, breach of the Goldsmith Agreement, fraud, vicarious liability of the TMX Defendants based on the conduct of their personnel, veil piercing, civil conspiracy, and aiding and abetting a breach of fiduciary duty.

The complaint alleged that, after the restructuring, Young orchestrated the following takeover scheme in order to obtain a controlling interest in ICOT Holdings without having to exercise the options: (1) caused an “existential funding crisis” by derailing funding from third-party capital providers; (2) refused to sign the guarantee for a previously negotiated line-of-credit unless he received warrants from Goldsmith and Jue, resulting in short-term cash flow problems; (3) drove away a third-party buyer with statements that put the company’s financial health in a poor light, disparaged Jue, and threatened to dilute the membership interests of Goldsmith and Jue; (4) initiated an inspection of ICOT’s books and records in preparation for the takeover; (5) leveraged the funding crisis to control ICOT Holdings’ board of managers by appointing an ally, misrepresenting that ally’s appointment was necessary for ICOT Holdings to draw on the line-of-credit; (6) coordinated vote with the ally to terminate Jue as manager of ICOT Hearing; and (7) diluted Goldsmith and Jue and obtained majority control by issuing a capital call when he knew that the line-of-credit was available and that the plaintiffs lacked the funds to make a pro rata contribution pro rata. After Young took control of ICOT Holdings, he contacted the same third-party buyer and proposed a discounted sale. Considering their diluted position and the discounted sale price, neither Goldsmith nor Jue would receive money from the sale. The defendants answered and later moved to dismiss, contending that the plaintiffs were not entitled to bring a direct claim and had failed to state any viable claims against them. The trial court denied the defendants’ respective motions. The defendants filed applications for interlocutory appeal, which the court granted, leading to the present companion appeals.

The court first considered the Young Defendants’ argument that the plaintiffs’ claims were derivative in nature because they were not separate and distinct from other members of ICOT Holdings and, thus, had to be brought pursuant to the procedural requirements for filing a derivative action under the Georgia Limited Liability Company Act. The court acknowledged the general rule that dilution claims are derivative because they do not constitute a separate and distinct injury but noted an exception where wrongdoers have seized control of the entity by fraud. Because the plaintiffs’ loss of control resulted from Young’s alleged takeover scheme in breach of his fiduciary duties as a manager and through false representations and omissions about funding, the court determined that the plaintiffs could bring a direct claim against the Young Defendants because the alleged harm to plaintiffs was different from that experienced by the company and its minority members and this special injury was sufficiently pled. Furthermore, the court determined that Goldsmith was entitled to bring a direct action for the alleged breach of the Goldsmith Agreement and Jue was entitled to bring a direct action based on his alleged wrongful termination as manager of ICOT Hearing.

Next, the Young Defendants contended that the plaintiffs failed to state a claim for breach of the ICOT Holdings’ Operating Agreement and breach of fiduciary duties. Specifically, the Young Defendants maintained that neither Young’s failure to provide additional funding beyond what was previously loaned and guaranteed under the Restructuring Agreement nor his vote for a capital call that led to dilution could support a claim for breach of the Operating Agreement or breach of fiduciary duty. The court cited the Georgia LLC Act and case law for the proposition that the managing members of an LLC owe fiduciary duties to the company and its members, but such fiduciary duties may be modified or eliminated by the operating agreement. Under the Operating Agreement, managers were required to act in good faith, refrain from intentional misconduct, and

avoid any improper personal benefits. The court disagreed with the Young Defendants, reasoning that Young (1) derailed additional funding from third-party capital providers solely to implement his takeover scheme; (2) refused to sign the line-of-credit guarantee solely to create a funding crisis; (3) made false representations to a prospective third-party buyer so as to delay any sale and increase his leverage over the plaintiffs; and (4) made false representations to Jue about the provider of the line-of-credit requiring the ally's appointment to ICOT Holdings' board of managers and orchestrating the capital call for the sole purpose of ousting the plaintiffs from control. Therefore, the court concluded that the complaint asserted that Young had acted in bad faith, had engaged in intentional wrongful conduct, and had acted for the purpose of obtaining an improper personal benefit.

Third, the court agreed with the defendants' argument that the plaintiffs failed to state a claim for breach of the Goldsmith Agreement. The complaint alleged that Goldsmith agreed to give TY Investments the options to purchase membership units from him "in exchange for Young complying with the terms of the Operating Agreement" and that Young breached this agreement when he allegedly violated his fiduciary duties. However, the Goldsmith Agreement contained a provision that specified Goldsmith's grant of the option to Young was in exchange for \$100 and Young's agreement to provide additional funds as part of the restructuring. Because Young's promise to comply with all of his duties as manager under the Operating Agreement was not part of the consideration for Goldsmith's grant of the option, the court concluded that the plaintiffs failed to state a claim for breach of the Goldsmith Agreement.

The court next considered the contention of the defendants that the plaintiffs failed to state a claim for fraud and failed to plead fraud with particularity. The court concluded that the complaint did not disclose with certainty that the plaintiffs would not be entitled to relief on their claim for fraud under any state of provable facts. Among the court's conclusions in this regard was its conclusion that the complaint did not indicate that the plaintiffs would be unable to come forward with evidence of fraudulent representations about additional funding that fell outside the scope of the merger clause in the Restructuring Agreement and that the contractual provision in the Goldsmith Agreement allowing for a due diligence inspection did not preclude the plaintiffs from pursuing a fraud claim based on the inspection that allegedly occurred.

The court then considered whether the plaintiffs sufficiently pled that the TMX Defendants could be held vicariously liable for their employees' actions when they inspected ICOT's books and records. According to the TMX Defendants, the complaint indicated that their personnel were acting at the direction of Young and not within the scope of and in furtherance of the TMX Defendants' business. The court observed that the complaint alleged that the TMX Defendants were owned and controlled by Young, that he had control over employees of the TMX Defendants, and that he used this control to fly employees of the TMX Defendants to ICOT's offices in order to inspect its books and records and to learn its operations. Therefore, the court relied on common-law agency principles to hold that the complaint sufficiently pled allegations of vicarious liability.

Sixth, the court considered the TMX Defendants' argument that the plaintiff sought to hold them liable for Young's alleged misconduct under an outsider reverse veil-piercing theory and that Georgia does not recognize this theory. Although the court agreed with the TMX Defendants that Georgia does not recognize outsider reverse veil piercing (i.e., imposing liability on the entity for a third-party judgment against an owner), it concluded that the plaintiffs stated a claim for veil piercing. The court cited Georgia case law for the proposition that the general purpose of veil piercing is to hold an individual owner liable for the obligations of the entity, but it can also be used to hold a parent company liable for the obligations of a wholly-owned subsidiary or to hold a family of entities liable for the obligations of each other. The court pointed out that the complaint included allegations that the TMX Defendants are a "family of companies" owned and governed solely by

Young, that Young controls all operations of the TMX Defendants, that Young used the TMX Defendants for the personal purpose of causing harm to the plaintiffs, and that veil piercing of the TMX Defendants is authorized and appropriate because Young used these “entities to defeat justice, perpetuate fraud, and evade contractual and tort responsibilities.” The court agreed with the TMX Defendants that Georgia law foreclosed any attempt to reach the assets of the TMX Defendants for a judgment debt personally incurred by Young under the theory of outsider reverse veil-piercing. However, construed in the light most favorable to the plaintiffs, the amended complaint stated a claim for holding TMX Finance, LLC, liable for any judgment debt incurred by its subsidiaries, TitleMax Texas, Inc. and TitleMax Georgia, Inc., under a veil-piercing theory, and for holding the TMX “family of companies” liable for any judgment debt incurred by each other under such a theory.

Finally, the court declined to dismiss claims against the TMX Defendants for aiding and abetting a breach of fiduciary duty and civil conspiracy.

In sum, the court of appeals affirmed the trial court and held that the plaintiffs could bring a direct action against the Young Defendants; that the plaintiffs’ complaint stated claims for breach of the Operating Agreement, breach of fiduciary duty, fraud, and veil piercing; and that the plaintiff could not pursue a claim for outsider reverse veil piercing under Georgia law but could pursue a traditional veil-piercing claim. The court also reversed in part, holding that the trial court erred by not dismissing the plaintiffs’ claims against the Young Defendants and the TMX Defendants for breach of the Goldsmith Agreement.

***Namerow v. PediatriCare Associates, LLC***, 218 A.3d 839 (N.J. Ch. Div. 2018).

A retired member brought an action against a New Jersey LLC and its three active members alleging various claims, including modification of the operating agreement by conduct, minority member oppression, and breach of fiduciary duties. The trial court granted summary judgment in favor of the LLC and its active members, holding that (1) the parties’ course of conduct over a sixteen-year period did not modify the operating agreement; (2) the economic loss doctrine barred the retired member from recovering damages based on a claim of minority member oppression; and (3) there was nothing to suggest that the active members breached any fiduciary duty owed to the retired member.

In January 2000, four doctors, Namerow, Zucker, Bienstock, and Chism entered into an operating agreement to form PediatriCare Associates, LLC, a New Jersey limited liability company, for the purpose of owning and operating a medical practice. In March 2001, the parties entered into an Amended and Restated Operating Agreement (the “Agreement”). The Agreement provided members with the right to retire once they had reached the age of sixty and had provided twenty-five years of membership or service to the practice. Furthermore, the Agreement prescribed that the “retirement purchase price” of a retiring member’s interest was calculated according to Section 10 of the Agreement (titled “Determination of Value”) as follows:

The total value of the company (“company value”) shall be the last dated amount set forth on the Certificate of Agreed Value, attached hereto as Exhibit G and made part hereto, executed by the members. The members shall exercise their best efforts to meet not less than once per year for the purpose of considering a new value but their failure to meet or determine a value shall not invalidate the most recently executed Certificate of Agreed Value setting forth the company value then in effect. If the parties fail to agree on a revaluation as described above for more than two (2) years, the company value shall be equal to the last agreed upon value, adjusted to reflect the

increase or decrease in the net worth of the company, including collectible accounts receivable, since the last agreed upon value. The value of a member's interest ("Value") shall mean the company value multiplied by the percentage interest held by said member and being purchased hereunder, less any indebtedness that the selling or disabled member, the Decedent, or a member departing for any other reason contemplated hereunder may have to the company or to the other members, whichever the case may be.

The most recent Certificate of Agreed Value attached to the Agreement, which stated that the "value of the company" was \$2.4 million, was dated January 1, 2000 and signed by Namerow, Zucker, Bienstock, and Chism.

Namerow announced his intention to retire in January 2016, which triggered the application of Section 10. Over the next several months, the parties obtained two appraisals, each using the fair market valuation methodology, for the purpose of reaching a settlement regarding the voluntary negotiated buyout number. No such number was ever reached and the Agreement was never amended.

Namerow filed this action on October 10, 2017 against Zucker, Bienstock, and Chism (collectively, the "Active Members") and the LLC, asserting claims for modification of the Agreement by conduct, oppression of a minority member, and breach of fiduciary duty. Both sides filed motions for partial summary judgment.

The first issue that the trial court addressed was whether the parties' course of conduct over a sixteen-year period modified the terms of the Agreement to require use of a fair market valuation, rather than a net worth valuation as required by Section 10, to value the practice. Namerow argued that the parties had modified the Agreement because they had ignored Section 10 on three prior occasions. The trial court was not persuaded and reasoned that there was no indication that the parties intended to informally modify Section 10 because one such occasion was wholly unrelated to the retirement buyout purchase price of a member and, based on this litigation, the other two occasions did not settle the disagreement. The court then noted that the Agreement stated that it can only be modified by a vote of 80% of the membership interests and there was no evidence that Namerow or the Active Members agreed to formally modify Section 10. Therefore, the trial court granted summary judgment in favor of the LLC and the Active Members on Namerow's claim that the parties' conduct modified Section 10 to require the use of a fair market valuation methodology to determine his retirement purchase price.

Next, the trial court addressed Namerow's claim of minority member oppression under the New Jersey Revised Uniform Limited Liability Company Act (the "New Jersey LLC Act"). Under the New Jersey LLC Act, judicial recourse is available to minority members who have been "oppressed" by the majority members. New Jersey case law defines "oppression" as "frustrating a [member's] reasonable expectations" and "is usually directed at a minority [member] personally[.]" Thus, a minority member has a genuine claim for oppression under the New Jersey LLC Act when their reasonable expectations have been frustrated by the majority members. According to Namerow, he had a reasonable expectation that his 25% membership interest would be purchased using a fair market valuation methodology. In further support of his oppression claim, Namerow referenced an earlier ruling from the court in which it denied the defendants' motion to dismiss because, at that time, his expectation was reasonable. The trial court pointed out that its earlier ruling was made at a preliminary stage in the litigation and, after discovery and the court's determination that the net worth methodology applied, it was clear that the defendants' conduct did not support a claim for oppression under the New Jersey LLC Act. Furthermore, the court cited New Jersey case law for the



proposition that the economic loss doctrine prohibits plaintiffs from recovering in tort economic losses to which their entitlement only flows from a contract. Because this claim was contractual in nature and Namerow's entitlement flowed from the Agreement, the trial court held that his minority member oppression claim failed as a matter of law because it was barred by the economic loss doctrine.

The third issue that the trial court addressed was whether the defendants breached the fiduciary duties owed to Namerow. Under the New Jersey LLC Act, each member of a member-managed LLC owes the company and the other members a duty of care. The court observed that Namerow's claim for breach of fiduciary duty was based on many of the same recycled allegations from his other claims and were unconvincing for the same reasons. The trial court further reasoned that there was no valid claim for breach of fiduciary duty based on the members of a member-managed LLC acting in conformity with the Agreement. Thus, the trial court granted summary judgment in favor of the LLC and the Active Members on Namerow's claim for breach of fiduciary duty.

### **Indemnification and Advancement**

*Homeland Energy Solutions, LLC v. Retterath*, 938 N.W.2d 664 (Iowa 2020).

In this dispute arising out of the refusal of an LLC member to sell his units back to the LLC pursuant to a member unit repurchase agreement executed by the member and the LLC, the Iowa Supreme Court held that: (1) the district court properly refused the member's demand for a jury trial because the LLC sought specific performance, which is a claim in equity; (2) neither the provisions of the LLC operating agreement nor Iowa law required member approval for the LLC to reacquire the member's units; (3) the member unit repurchase agreement was a binding contract despite the member's attempt to revoke his offer to sell his units; (4) the remedy of specific performance against the member was warranted; (5) the member's affirmative defenses were without merit; and (6) the indemnification provision in the member unit repurchase agreement did not support an award of attorney's fees against the breaching member because it did not clearly evidence the parties' intent to shift fees as opposed to protecting each party from claims brought by third parties.

In 2000, Steve Retterath purchased 25,860 Homeland Energy Solutions, LLC (HES) units for approximately \$26 million during HES's initial offering of equity securities. In late 2012, Retterath began discussions with HES about selling his HES units. A buyback committee was created to negotiate the repurchase of the units. By early 2013, Retterath and the buyback committee had not reached an agreement. Negotiations continued into the summer of 2013 when Retterath and the HES board committee were finally able to come to an agreement on the terms of a membership unit repurchase agreement (MURA). The final MURA provided for HES to pay Retterath \$30 million in two installments, one at closing and the other by July 1, 2014. In June 2013, Retterath and HES executed the MURA. Four days after the execution, HES's board approved the MURA, but five days after the execution and one day after HES's board approval, Retterath attempted to revoke his offer to sell his units because he learned that the tax treatment of the payments would be ordinary income rather than capital gains. At no time did HES's members vote to approve the agreement. Throughout the summer, Retterath continued to express his opinion that there was no agreement to sell because he had revoked his offer, but HES spent the rest of the summer preparing for an August 1, 2013 closing date. The scheduled closing did not happen on August 1, 2013, and HES filed a suit in equity seeking specific performance as the remedy. After a bench trial, the district court found that there was a binding agreement, held that Retterath breached the agreement, rejected Retterath's affirmative defenses, and ordered Retterath's specific performance under the agreement.

The district court also awarded HES attorney's fees against Retterath based on the indemnification clause in the MURA.

After analyzing and agreeing with the district court's conclusions that the MURA was a validly approved and binding contract, that HES was entitled to specific performance, and that Retterath's affirmative defenses failed, the court turned to the issue of whether the MURA supported an award of attorney's fees against Retterath. HES relied on the following indemnification provision of the MURA in support of its claim for recovery of attorney's fees:

Member agrees to indemnify, defend and hold harmless the Company and its members, managers, officers, directors, employees and representatives from and against any and all claims, suits, losses, liabilities, costs, damages, expenses, including reasonable attorneys' fees and costs, arising, directly or indirectly, out of or resulting from: (i) any breach or material inaccuracy of any representation or warranty by Member contained in this Agreement; or (ii) failure by Member to perform his obligation under this Agreement.

The court discussed case law in which it had held that indemnification clauses that use the terms "indemnify" and "hold harmless" evidence the parties' intent to protect a party from claims brought by third parties and cannot be used to shift attorney fees between the parties "unless the language of the clause shows an intent to clearly and unambiguously shift the fees." Based on this case law, the court held that the indemnification provision did not clearly and unambiguously express Retterath's and HES's intent to shift the attorney fees HES incurred in this breach of contract action. HES attempted to distinguish the MURA from the case law relied upon by the court on the ground that there were no plausible scenarios where a third-party would bring an action against HES if Retterath breached the MURA, but the court rejected that contention, pointing to examples in which Retterath's breach of the MURA could result in a third-party action against HES. Although the court agreed with Retterath on this point and reversed the district court's award of attorney's fees against him, the supreme court rejected Retterath's argument that he was entitled to sanctions against HES for having sought attorney's fees under the indemnification provision.

***Tangas v. International House of Pancakes LLC***, 779 F. App'x 317 (6th Cir. 2019).

The court of appeals reversed the district court's summary judgment in favor of a Delaware LLC and its parent corporation on the indemnification claims of a former employee of the LLC. The court held that the employee's rights vested under the LLC operating agreement before her termination; the business judgment rule did not apply to the LLC's determination that the employee's conduct amounted to fraud, willful misconduct, and bad faith; and genuine issues of material fact existed with respect to the employee's claims that she was entitled to indemnification under the parent corporation's bylaws and the LLC operating agreement.

Autumn Lee Tangas worked for International House of Pancakes, LLC ("IHOP"), a Delaware LLC, for more than two decades and eventually became a "franchise bureau consultant." In that role, Tangas acted as a liaison between IHOP and franchisees to help franchisees improve profits and ensure that they adhered to IHOP operating standards. In 2004, Tangas and her domestic partner were involved in a financial transaction with a franchisee known as Terry Elk, whose operations Tangas oversaw. The purpose of the transaction was unclear, and eventually the money that was exchanged was returned. Years later, in 2011, the FBI raided Elk's IHOP operations and questioned Tangas. The same day, Tangas informed the in-house counsel of IHOP's parent company, DineEquity, Inc., a Delaware corporation, about the interview with the FBI even though agents asked

her not to discuss the conversation. In 2012, DineEquity's in-house counsel communicated to Tangas's lawyer that Tangas was obligated to cooperate with IHOP's 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 Elk, Tangas, and others. The indictment, which charged Tangas with money laundering and hiring undocumented workers at Elk's IHOP locations, essentially alleged that Tangas used her position as a franchise bureau consultant to hide Elk'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 and DineEquity pay these legal fees. The companies refused to pay, and Tangas sued on the basis that DineEquity's bylaws and IHOP's LLC agreement entitled her to indemnification. The district court granted summary judgment in favor of DineEquity and IHOP, holding that Tangas was not entitled to indemnification under DineEquity's bylaws or IHOP's LLC agreement and that IHOP's decisions were protected by the business judgment rule. The court of appeals disagreed with the district court's interpretation of the bylaws and LLC agreement and concluded that there were genuine issues of material fact regarding Tangas's conduct that affected her rights under the governing documents. Thus, the court of appeals vacated the summary judgment and remanded.

The court of appeals first addressed the indemnification provision of DineEquity's bylaws, which provided that DineEquity:

**shall indemnify any person** who was or is a party or is threatened to be made a party to **any threatened, pending** or completed action, suit or proceeding, whether civil, **criminal**, administrative or investigative (other than an action by or in the right of the Corporation) by reason of the fact that 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, against expenses (**including attorneys' fees**) judgments, fines and amounts paid in settlement actually and reasonably incurred by him in connection with such action, suit or proceeding **if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the Corporation**, and, with respect to any criminal action or proceeding, had no reasonable cause to believe his conduct was unlawful.

(Emphasis added by the court.)

The court of appeals disagreed with the district court's conclusion that "an employee of a subsidiary company serves 'at the request of' its parent company only when the parent company appoints the employee to a specific position" and concluded that there were factual disputes as to whether Tangas was serving IHOP at the request of DineEquity. Additionally, the court concluded that a trier of fact must determine whether Tangas acted in good faith. The court noted that the Delaware corporate indemnification statute articulates a policy favoring indemnity of former officers and directors and that Delaware courts have consistently held that dismissal of criminal charges is by definition success on the merits. However, the court pointed out that this case involved contractual indemnification rather than statutory rights. On remand, the district court would have to

conduct a trial to assess whether Tangas was serving IHOP at the request of DineEquity as well as whether she acted in good faith.

The court next turned to the indemnification provision of the IHOP LLC agreement, which provided as follows:

**To the fullest extent permitted by law**, 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** or (ii) any Claim initiated by such Covered Person unless such Claim (or part thereof) (A) was brought to enforce such Covered Person's rights to indemnification hereunder or (B) was authorized or consented to by the Member. Expenses incurred by a Covered Person in defending any Claim shall be paid by the Company in advance of the final disposition of such Claim upon receipt by the Company of an undertaking by or on behalf of such Covered Person to repay such amount if it shall be ultimately determined that such Covered Person is not entitled to be indemnified by the Company as authorized by this Section 8.2.

(Emphasis added by the court.) The agreement defined a "Covered Person" as "the Member, or any officers, directors, stockholders, partners, **employees**, affiliates, representatives or agents of any of the Member, nor any officer, employee, representative or agent of the Company" (emphasis added by the court). The parties agreed that Tangas was a "Covered Person" until she was terminated, but IHOP argued that she was no longer entitled to indemnity after she was fired.

Because most of Tangas's legal fees were incurred after her termination, a significant issue bearing on the application of the LLC agreement was whether the indemnification provision included "terminated" or "former" employees. The court discussed this issue but concluded that it was not dispositive because the court concluded that Tangas's rights vested before her termination. Unlike DineEquity's bylaws, the LLC agreement did not say anything about "current" versus "former" employees. The court concluded that the district court erred in concluding that the absence of a modifier in the list of "Covered Persons" suggested only current employees were eligible for indemnity and stated that any ambiguity in this regard should be construed against the drafter. The court characterized the question of whether the LLC contemplated indemnity for former employees as a "close one," but thought the more logical conclusion was that former employees were included in an ambiguous LLC agreement for the policy reasons articulated in Delaware (corporate) statutory and case law. Ultimately, the court stated that it need not resolve the issue in light of its conclusion (discussed below) that Tangas's rights vested before her termination, but the court made the point that it did not agree with the district court's method of resolving the issue by comparing DineEquity's bylaws to IHOP's LLC agreement. Characterizing the documents as independent, the court did not think that the clearer document informed the more ambiguous.

In concluding that Tangas’s rights to indemnification vested before her employment was terminated, the appellate court relied on two cases distinguished by the district court—*Branin v. Stein Roe Inv. Counsel, LLC*, No. 8481–VCN, 2014 WL 2961084 (Del. Ch. June 30, 2014), and *Salaman v. National Media Corp.*, No. 92C–01–161, 1992 WL 808095 (Del. Super. Ct. Oct. 8, 1992). The court of appeals acknowledged that “[i]t is true that these cases do not announce that all indemnity provisions everywhere function as rights that vest,” but the court went on to explain that “corporations offering indemnity rights are bound to deliver that benefit when a covered person is targeted, presuming of course that the employee acted in good faith. Otherwise, a corporation could simply fire anyone under investigation, rendering indemnity provisions a nullity. This inequity is exactly what Delaware law guards against. When the FBI came to Tangas’s door, her indemnity rights vested because the LLC Agreement is written expansively to contemplate coverage for threatened and investigative actions. Indemnity is designed for precisely this situation when an employee is sued and is later found not guilty or not liable. The distinction between ‘former’ and ‘current’ employees is irrelevant because Tangas’s rights vested under the Agreement when the FBI began investigating her and before IHOP fired her.”

The court next addressed IHOP’s argument that Tangas’s bad conduct barred her indemnification claim even if she was entitled to indemnification under the LLC agreement. IHOP argued that Tangas’s failure to report the financial transaction with Elk in 2004 and her failure to cooperate in the internal IHOP investigation in 2011 and 2012 amounted to fraud, willful misconduct, and bad faith under the LLC agreement and that IHOP was entitled to deference on its determination that Tangas engaged in these activities. In its summary judgment ruling, the district court applied the business judgment rule to conclude that no reasonable jury could challenge IHOP’s decision, but the court of appeals rejected the notion that the business judgment rule applied to IHOP’s determination that Tangas was not entitled to indemnification. The court explained that “the business judgment rule is irrelevant to this case because there is no decision over which a corporation’s board could exercise its business judgment. A legal question of contract interpretation is not within a board’s purview.” The court stated that “[t]he business judgment rule might be relevant in an indemnity context if the bylaws or operating agreement make indemnity discretionary. That is not true here because the drafter of the LLC Agreement employed the word ‘shall.’”

Finally, IHOP argued that Tangas was not entitled to indemnity, even if the business judgment rule did not apply, because she broke the rules with regard to the Elk transaction and failed to cooperate with management in 2011 and 2012. However, both of these issues were hotly disputed by the parties, and the court concluded that a trial on the issue of Tangas’s good faith was necessary. The court stated that some case law suggests that expansive contractual language and dismissal of the criminal charges and lack of underlying criminal liability would render the indemnitee’s state of mind irrelevant, but other authority concludes otherwise. Ultimately, the court held that “IHOP is not entitled to deference on the good faith question because its indemnification procedures are directive and broad. But holding that the dismissal of Tangas’s charges satisfies the good faith provision would render the provision of the LLC Agreement discussing misconduct a nullity. Thus, a trial is necessary.”

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

*Benjamin v. Bierman*, 943 N.W.2d 283 (Neb. 2020).

In an action by a deceased member’s personal representative seeking judicially ordered dissolution of two LLCs and asserting breach of contract by the surviving members based on their failure to buy out the deceased member’s interests, the Nebraska Supreme Court held that the

personal representative lacked standing to seek dissolution of LLCs because she was not a member. With respect to the breach-of-contract claim, the court held that the operating agreements' repurchase provisions required a determination of fair market value of the deceased member's interest by agreement of the parties or, absent agreement, by an independent appraiser, and the trial court did not clearly err in its findings regarding the actions taken in connection with the appraisal and buyout process, including its finding that the surviving members failed to negotiate in good faith and breached the operating agreements.

Mark Benjamin owned a one-half interest in Sixth Street Rentals, LLC ("Rentals") along with Doug Bierman and a one-third interest in Sixth Street Development, LLC ("Development") along with Doug Bierman and Doug's father, Eugene Bierman. Mark passed away on April 14, 2015, leaving his wife Brenda Benjamin as his primary beneficiary and the personal representative of his estate. Prior to his death, Mark was acting manager of both LLCs. After Mark's death, Doug took over the manager position for both LLCs.

Counsel for both Rentals and Development sent notices to Brenda pursuant to the respective separate but identical operating agreements, stating the LLCs' intention to buy Mark's interests. Brenda testified at trial that she and Doug had generally reached an agreement pursuant to which Doug would buy out Mark's interest in Rentals, and Doug and Eugene would buy out Mark's interest in Development. Brenda would receive Development's interest in a store facility jointly owned by Development, a third party, and Mark's estate as an offset for the purchase price for Mark's interest in Development.

The parties agreed to close on the buyouts of Mark's interests in Rentals and Development as well as a corporation in which Mark owned shares on April 15, 2016. The parties had valuations done on Rentals and Development by Terry Galloway. The parties did not close on the specified date, and Brenda sued the Biermans and the LLCs on June 1, 2016. After a bench trial, the trial court found that the Biermans, Rentals, and Development had breached the operating agreements of Rentals and Development, ordered an accounting for each company, declined to dissolve either, and awarded Brenda damages.

Brenda appealed the trial court's decision not to order dissolution of both Rentals and Development. The Biermans, Rentals, and Development (collectively, the "Bierman parties") cross-appealed alleging numerous points of error. The court grouped the Bierman parties' points of error into the following categories: assignments of error related to fair market value, assignments of error related to breach of contract and specific performance, and remaining assignments of error.

The court first dealt with Brenda's appeal. After concluding that Brenda did not have the right to seek judicial dissolution under the Nebraska LLC statute because she was not a member, the court addressed Brenda's argument that the operating agreement granted Mark the power to transfer governance power, along with his economic interest, in Rentals and Development. The provision relied upon by Brenda provided:

Any Member may transfer by gift or bequest all or any portion of his or her interest in the Company to a spouse or child of the transferring Member, or to a trust established for the benefit of such spouse or child, or to an existing Member of the Company upon written notice to the Company, of such gift or bequest.

The court interpreted the plain language of this section as permitting the transfer of some or all of a member's or dissociated member's interest in an LLC by gift or bequest, noting that the Nebraska LLC statute provides that an interest in an LLC is personal property that is transferable. But the court pointed out that the transfer of an interest is accompanied by limited rights under the LLC statute,

and the court did not read the language of the operating agreements as broadening the rights accompanying the interest to include governance power or any other power beyond that provided by the statute.

The court then turned to the numerous points of error brought by the Bierman parties on cross-appeal. The primary arguments centered around the fair market value of Rentals and Development. The Bierman parties argued that the operating agreement did not set forth an unambiguous method for determining the fair market value of Rentals and Development. Brenda argued that the operating agreements were clear in setting out fair market value determinations by either allowing the parties to agree to fair market value or, absent agreement, to appoint an independent third-party appraiser.

The relevant language of the operating agreement stated:

In the event that a Member dies..., the Company may at its option repurchase the deceased...Member's interest in the Company for an amount equal to the fair market value of such interest on the Member's date of death... The fair market value of the Member's interest shall be as agreed in good faith by the Company and the personal representative(s) of the deceased Member's estate...; provided that if no such agreement has been reached within ninety (90) days of the date of death..., then the fair market value shall be determined by an independent and duly qualified appraiser mutually agreeable to the Company and the estate of the deceased Member ... which shall equally bear equally [sic] the cost of such appraisal. The fair market value of the deceased Member's interest...shall be payable by the Company to the deceased Member's estate... within one hundred twenty (120) days of the establishment of such fair market value on the same payment terms as set forth in Section 9.4 of this Agreement.

The supreme court disagreed with the Bierman parties' argument that "fair market value" is a term of art necessitating reliance on factors outside of the agreements and agreed with Brenda's reading of the language of the operating agreements. The court found it unnecessary to rely on anything further to interpret the agreements' definition of "fair market value" because the plain language of the agreements stated that "the fair market value shall be determined by an independent and duly qualified appraiser mutually agreeable to the Company and the estate of the deceased Member."

The Bierman parties also complained of the trial court's finding that Galloway's appraisal was the fair market value of Rentals and Development, that Galloway was independent at the time of his appraisal, that Galloway used the appropriate date for his valuation, and that the appraisal was substantially completed as of November 30, 2015. The court found no clear error by the trial court with respect to any of these matters. The court stated that credibility of a witness is a question for the trier of fact and that the record showed that the parties agreed Galloway should conduct the appraisal pursuant to the operating agreement, that they agreed the appraisal date should be December 31, 2014, rather than date of Mark's death four months later, and that the appraisal was substantially completed as of November 30, 2015, thus starting the 120-day clock on the payment obligation under the operating agreement.

The Bierman parties next complained of the trial court's findings that they failed to negotiate in good faith, but the supreme court stated that the evidence supported Brenda's claim that, despite having agreed on the value of Rentals and Development, the Bierman parties rejected Galloway's valuation and failed to close on the purchase of Mark's interests in Rentals and Development only

after the parties could not reach an agreement on the value of BD Construction, Inc. (the other entity in which Mark was a co-owner). The trial court heard conflicting testimony from Doug and Brenda regarding a meeting to negotiate values of Rentals and Development as well as BD Construction, Inc., and the record showed that the trial court found Brenda more credible.

The court also rejected the Bierman parties' argument that the trial court erred in not ordering specific performance of the contract for purchase of Mark's interests. A court cannot award specific performance to the breaching party unless the breach is minor or involves no substantial failure of the exchange, but the trial court specifically found that the breach was not minor and was a substantial failure of the exchange. Because the breach involved failure to close on the sale after the terms of the operating agreements regarding the sale were met, the supreme court concluded that the breach was not minor, but rather was a substantial failure of the exchange.

The final points of error asserted by the Bierman parties included the trial court's failure to adopt the values of the experts they provided at trial, the court's order to pay interest on the damages award, and the court's award of damages to Brenda. The supreme court found either no merit in these arguments or no clear error by the trial court.

***Matter of Estate of Cook***, 601 S.W.3d 453 (Ark. Ct. App. 2020).

The court of appeals reversed and remanded the trial court's order directing that a deceased member's ownership interest in a two-member Arkansas LLC pass to his estate rather than to the surviving member. The trial court found that the transfer-upon-death provision in the operating agreement failed due to lack of consideration, but the court of appeals held that the LLC's operating agreement unambiguously showed the members intended for a deceased member's ownership interest to transfer automatically to the surviving member and that the members supplied the necessary consideration for this automatic transfer through multiple mutual promises throughout the operating agreement.

In December 2014, Charles Cook and his grandson Jared Brooks formed Cook's Towing and Recovery, LLC, pursuant to a seven-page operating agreement filed with the Arkansas Secretary of State. Cook and Brooks, as the only members, each owned a 50% ownership interest in the LLC. A provision in the operating agreement provided that upon either member's death, incompetency, or bankruptcy, that member's ownership, interest, and income from the LLC would immediately transfer to the surviving member, without any buyout required. The operating agreement also stated that a member could sell or transfer his ownership interest with the consent of the other member but granted a right of first refusal. At the time of Cook's death in April 2017, the LLC's assets included vehicles used in the towing business as well as Cook's personal residence. Cook had three surviving children: Charlotte Smith (Brooks' mother), Crista Bowker, and Amy Willhite.

During a hearing in the probate proceedings, the trial court instructed the parties to submit briefs on Willhite's motion to determine that Cook's interest in the LLC did not pass automatically to Brooks but should be considered an asset of the estate. Brooks' trial brief asserted in part that the operating agreement was an independent, valid, and binding contract that clearly stated Cook's intent to have his ownership interest in the LLC transfer upon his death to Brooks as the surviving member. Smith filed a statement that she had no objection to the LLC being vested completely in Brooks. On the other hand, Willhite's brief attacked the validity of the LLC's creation. She argued that there was no valid business reason for Cook to transfer his personal residence to the LLC and claimed that there was no proof that Cook agreed to the language transferring his interest to Brooks because the operating agreement was missing dates, page numbers, initials of the signatories, and verification by a witness or notary. Willhite also claimed that the transfer provision in the operating agreement was an attempt to accomplish a testamentary disposition in an unverified and unwitnessed contract.



Concerning the ownership of the LLC interest, the trial court entered an order in which it directed that Cook's interest be considered an asset of his estate. The trial court found that, although the transfer of Cook's interest pursuant to the operating agreement was contractual in nature and not testamentary, the transfer provision lacked consideration and could not be effectuated. As a result, the court severed this provision from the remainder of the operating agreement in accordance with the severability clause in the agreement. The order further found that Brooks had a contractual right under the operating agreement to purchase Cook's interest from the estate as if Cook were selling his interest to a third party under the right of refusal clause. Brooks and Smith appealed.

Brooks and Smith contended that the trial court erred when it found that the operating agreement did not transfer Cook's ownership interest in the LLC to Brooks upon Cook's death. The court began its analysis by reviewing Arkansas case law for traditional principles of contractual interpretation and construction. Next, the court noted that Arkansas LLCs are authorized by the Small Business Entity Pass Through Act (the "Arkansas Act"), which defines an "operating agreement" as the written agreement entered among all members as to an LLC's business and affairs. The court pointed out that the Arkansas Act does not indicate any specific requirements or contents of the operating agreement itself but does provide that a person ceases to be a member of an LLC upon the person's death unless otherwise provided in writing in an operating agreement. The court then observed that the LLC's operating agreement specifically addressed what should happen if a member died, citing sections 8.4 and 8.7 as follows:

[8.4] On the death, adjudicated incompetence, or bankruptcy of a Member, the living member shall be the sole successor in interest to the deceased Member. Upon the death, incompetency, or bankruptcy of Jared Brooks, his ownership, interest, and income from the Company shall immediately transfer to Charles Cook. *Upon the death, incompetency, or bankruptcy of Charles Cook, his ownership, interest, and income from the Company shall immediately transfer to Jared Brooks.* In the event there is any legal contest to this automatic transfer of ownership, any other successors in interest to any deceased, incompetent, or insolvent Member (whether an estate, bankruptcy trustee, or otherwise) will receive only the economic right to receive distributions whenever made by the Company and the deceased, incompetent, or insolvent Member's allocable share of taxable income, gain, loss, deduction, and credit (the "Economic Rights").

[8.7] [U]pon the transfer of the interest in the Company by any deceased, incompetent, or insolvent Member, *there shall be no buy out required to accomplish the transfer upon death/incompetency/insolvency of either Charles Cook or Jared [Brooks].* All interest, shares, profits, and ownership shall automatically transfer to the remaining competent/solvent party.

(Emphasis added by court.)

The court of appeals determined that the trial court properly recognized that this was a contractual transfer but erroneously found that the transfer failed due to lack of consideration. The court held that the language of sections 8.4 and 8.7 "clearly and unambiguously" established that Cook and Brooks intended for his ownership interest in the LLC to pass automatically and immediately to the surviving member in the event of either of their deaths. After stating the proposition that mutual promises made for the other constitute consideration, the court of appeals

identified the following such promises between Cook and Brooks in the operating agreement: the two members contributed initial capital to the LLC; each agreed to operate and manage the company; and the transfer provisions applied to both of them and were structured so that they gave up rights for their respective estates and heirs to receive a buyout from the other. Thus, the court of appeals held that Cook and Brooks supplied the necessary consideration for the automatic transfer of ownership interest.

Willhite and Cook's estate argued that the issue of adequate consideration should be analyzed at the time of death and asserted that the consideration given for the creation of the LLC should not be the same consideration to support the transfer that would occur only upon the death of Cook or Brooks. The court of appeals was not persuaded, reasoning that their position ignored contract-construction principles that require the terms of the contract be read as a whole. Because Cook and Brooks created an LLC under the Arkansas Act and drafted an operating agreement to include terms clearly intending for the automatic transfer of a deceased member's interest to the surviving member, the court concluded that Cook's interest transferred to Brooks and not to Cook's estate. As a result, the court of appeals reversed and remanded the trial court's order determining that Cook's interest in the LLC was an asset of his estate.

***Estate of Streightoff v. Commissioner of Internal Revenue***, 954 F.3d 713 (5th Cir. 2020).

The court affirmed the tax court's ruling that an estate held a substituted limited partnership interest, and not an unadmitted assignee interest, in a Texas limited partnership.

In 2008, Frank Streightoff formed Streightoff Investments, LP ("SILP"), a Texas limited partnership [although identified by the court as a "limited liability partnership"], and established the Frank D. Streightoff Revocable Living Trust (the "Revocable Trust") for estate-planning purposes. Frank later died testate in 2011. SILP was funded using Frank's assets and its ownership was structured as follows: Streightoff Management, LLC ("LLC GP") held a 1% limited partnership interest as SILP's sole general partner, Frank held an 88.99% limited partnership interest, his daughters each held a 1.54% limited partnership interest, and his sons and former daughter-in-law each held a 0.77% limited partnership interest. Elizabeth Streightoff, one of Frank's daughters, was the trustee of the Revocable Trust, the managing member of LLC GP, his power of attorney, and the executor of his estate (the "Estate"). On the same day that he created SILP and the Revocable Trust, Frank assigned his 88.99% interest in SILP to the Revocable Trust. Elizabeth executed the Assignment of Interest to the Revocable Trust (the "Assignment") as Frank's power of attorney. She also signed (1) the approval of the transfer as LLC GP's managing member, SILP's general partner; and (2) for the assignee, as trustee for the Revocable Trust. The Assignment stated, "Assignor's interest ... together with all and singular the rights and appurtenances thereto in anywise belonging, unto the said Assignee, its beneficiaries and assigns forever."

The Estate filed its tax return in May 2012 with a taxable estate that included the SILP interest as an assignee interest with a purported valuation that claimed discounts for lack of marketability, lack of control, and lack of liquidity. The Commissioner of Internal Revenue (the "Commissioner") issued a Notice of Deficiency (the "Notice") to the Estate in January 2015. Attached to the Notice was a form in which the Commissioner stated that the fair market value of the Estate's 88.99% interest was corrected and increased because the net asset value should only be discounted for a lack of marketability. The Estate petitioned the tax court for a redetermination of the estate tax deficiency. Following a bench trial, the tax court sustained the Commissioner's determinations and ruled, in part, that the Estate held a substituted limited partnership interest in SILP. According to the tax court, the Assignment validly assigned to the Revocable Trust the 88.99% interest as a limited partnership interest both in substance and form. Therefore, the Estate,

as the beneficiary of the Revocable Trust, included a limited partnership interest in SILP. The Estate appealed.

With respect to the characterization of the assigned interest in SILP, the Estate contended that the tax court's substance-over-form rationale stood contrary to Texas partnership law. The court of appeals began its analysis by stating that a tax court relies on state law to discern the types of assets held within an estate. Because the SILP partnership agreement (the "SILP Agreement") provided that Texas was the governing jurisdiction, the court would look to § 153.251(b) of the limited partnership statute if the SILP Agreement was silent. Tex. Bus. Orgs. Code § 153.251(b) (outlining provisions for partnership assignments that apply *unless* "otherwise provided by the partnership agreement") (emphasis supplied by the court). By its terms, the Assignment was governed by the SILP Agreement. Therefore, the court would look only to the SILP Agreement because it was not silent as to the nature of the interest transferred under the Assignment. The court then focused on the following two provisions of the SILP Agreement:

9.2 Permitted Transfers.... [A]n Interest Holder may at any time [t]ransfer his Interests to (a) any member of transferor's Family, (b) the transferor's executor, administrator, trustee or personal representative to whom such interests are transferred at death or involuntarily by operation of law, or (c) [to any purchaser, but subject to the right of first refusal held by the persons listed in section 9.4]

...

9.7 Admissions of Interest Holders as Partners. A transferee of an Interest may be admitted to the Partnership as a Substituted Limited Partner only upon satisfaction of the conditions set forth below:

(a) Each General Partner consents to such admission which consent may be granted or withheld in the sole and absolute discretion of each General Partner;

(b) The Interests with respect to which the transferee is being admitted were acquired by means of a Permitted Transfer ....

The Estate argued that the Assignment conveyed only an unadmitted assignee interest to the Revocable Trust as a matter of form because (1) LLC GP did not consent to the admission of a transferee or assignee as a Substituted Limited Partner under Section 9.7(a); and (2) the Assignment's written approval was limited to effectuate the transfer under Section 7.2, which required written approval for an assignment of interest. The Commissioner argued, and the court agreed, that the Assignment's broad language transferred Frank's full partnership rights to the Revocable Trust and Elizabeth consented to that transfer as a substituted limited partnership interest when she signed and approved the Assignment.

The court of appeals concluded that LLC GP consented to the transfer of a substituted limited partnership interest to the Revocable Trust when Elizabeth signed the Assignment. First, the court stated that Section 9.7(b) was satisfied because the parties had stipulated that the Assignment was a Permitted Transfer under Section 9.2. Second, the court reasoned that Section 9.7(a) was satisfied when Elizabeth, as managing member of LLC GP, SILP's general partner, signed the Assignment under the "Approved By" legend. The court observed that, while the SILP Agreement used consent and approval interchangeably, the words were only distinguished with the qualifier "written."

Because this qualifying language was absent in Section 9.7(a), Elizabeth had unilateral discretion to admit the assigned interest as a Substituted Limited Partner. The court explained that, when Elizabeth gave written approval with her signature, it was binding on SILP and represented SILP's recognition that the Assignment conveyed "all and singular ... [SILP] rights and appurtenances" of Frank, which encompassed his 88.99% limited partnership interest. Third, the court determined that this stipulated Section 9.2 Permitted Transfer did not need to adhere to Section 7.2 and, in any event, Elizabeth's signature could satisfy both Section 7.2 and Section 9.7 because Section 9.7(a) did not specify the type of approval necessary. The court further reasoned that her signature made no attempt to either disclaim the portion of the Assignment purporting to convey the entirety of Frank's limited partnership interest or otherwise confine the written approval to any particular section of the SILP Agreement. Fourth, the court noted that the unambiguous language of the Assignment purported to convey more than an assignee interest, which was limited to allocations and distributions under the SILP Agreement. The court commented that, notwithstanding the document's label, it was "difficult to reconcile the Estate's characterization of the Assignment given [its] language."

Next, the court of appeals concluded that the Assignment was the functional equivalent of transferring a limited partnership interest because the transfer lacked economic substance outside of tax avoidance. The court referenced case law for the proposition that the substance-over-form doctrine permits it to determine the characterization of a transaction based on the underlying substance and not the legal form. After acknowledging that SILP limited partners appeared to have managerial power that unadmitted assignees did not, the court noted that there were no practical differences after executing the Assignment and observed that no limited partners other than Elizabeth exercised their partnership rights and responsibilities. The court further reasoned that, even if it were to assume that the Assignment transferred to the Revocable Trust an unadmitted assignee interest as a matter of form, there was no substantial difference before and after the transfer.

In sum, the court of appeals held that the Assignment transferred to the Revocable Trust the 88.99% interest as a substituted limited partnership interest as opposed to an unadmitted assignee interest, stating that this interpretation complied with the SILP Agreement and did not offend Texas partnership law. Thus, the court of appeals affirmed the tax court's ruling that the Estate, in turn, held a substituted limited partnership interest in SILP.

***Homeland Energy Solutions, LLC v. Retterath***, 938 N.W.2d 664 (Iowa 2020).

In this dispute arising out of the refusal of an LLC member to sell his units back to the LLC pursuant to a member unit repurchase agreement executed by the member and the LLC, the Iowa Supreme Court held that: (1) the district court properly refused the member's demand for a jury trial because the LLC sought specific performance, which is a claim in equity; (2) neither the provisions of the LLC operating agreement nor Iowa law required member approval for the LLC to reacquire the member's units; (3) the member unit repurchase agreement was a binding contract despite the member's attempt to revoke his offer to sell his units; (4) the remedy of specific performance against the member was warranted; (5) the member's affirmative defenses were without merit; and (6) the indemnification provision in the member unit repurchase agreement did not support an award of attorney's fees against the breaching member because it did not clearly evidence the parties' intent to shift fees as opposed to protecting each party from claims brought by third parties.

In 2000, Steve Retterath invested several million dollars in three ethanol plants, one of which was Homeland Energy Solutions, LLC (HES). All three plants were formed as Iowa LLCs, and the interests were divided into units. Retterath purchased 25,860 HES units for approximately \$26 million during HES's initial offering of equity securities. His units gave him the right to appoint two

members of HES's board of directors. Until June 2013, Retterath occupied one of those seats. Retterath was HES's largest unit holder, owning about 28% of the units.

In late 2012, Retterath began efforts to liquidate his investments in the three ethanol companies. He successfully negotiated and entered into member unit repurchase agreements with the other two companies and began discussions with HES about selling his HES units. A buyback committee was created to negotiate the repurchase of the units. By early 2013, Retterath and the buyback committee had not reached an agreement. Around this time, relations between Retterath, HES employees, and HES board members broke down. Retterath attempted to put friendly board members in place and even gave an HES director a check in the amount of \$100,000 to induce the director to vote with Retterath on board matters. HES began a bribery investigation into Retterath's conduct.

Negotiations continued into the summer of 2013 when Retterath and the HES board committee were finally able to come to an agreement on the terms of a membership unit repurchase agreement (MURA). The final MURA provided for HES to pay Retterath \$30 million in two installments, one at closing and the other by July 1, 2014. In June 2013, Retterath and HES executed the MURA. Four days after the execution, HES's board approved the MURA, but five days after the execution and one day after HES's board approval, Retterath attempted to revoke his offer to sell his units because he learned that the tax treatment of the payments would be ordinary income rather than capital gains. At no time did HES's members vote to approve the agreement.

Throughout the summer, Retterath continued to express his opinion that there was no agreement to sell because he had revoked his offer, but HES spent the rest of the summer preparing for an August 1, 2013 closing date. HES procured all of the necessary financing and lender approval necessary to repurchase the units. The scheduled closing did not happen on August 1, 2013. On August 14, 2013, HES filed a suit in equity seeking specific performance as the remedy. After HES filed suit, a long and complicated procedural battle took place during which two members allied with Retterath were allowed to intervene in the case. After a bench trial, the district court found that there was a binding agreement, held that Retterath breached the agreement, rejected Retterath's affirmative defenses, and ordered Retterath's specific performance under the agreement.

The supreme court began by discussing two procedural issues, one of which was whether the district court erred in striking Retterath's jury demand. The court affirmed the district court's decision to strike Retterath's jury demand because HES's claim was one of equity. HES claimed Retterath breached the MURA by failing to perform and sought specific performance.

The supreme court next discussed whether member approval of the MURA was required by HES's operating agreement. Retterath (and the two other intervening members) argued that section 5.6 of the operating agreement required member approval of the MURA. Section 5.6 provided as follows:

(b) The Directors shall not have authority to, and they covenant and agree that they shall not cause the Company to, without the consent of a majority of the Membership Voting Interests:

....

(v) Cause the Company to acquire any equity or debt securities of any Director or any of its Affiliates, or otherwise make loans to any Director or any of its Affiliates.

HES, however, argued that the following language of section 5.16(vii) of the operating agreement granted the board of directors the sole authority with respect to reacquiring a member's units:

Board committees may exercise only those aspects of the Directors' authority which are expressly conferred by the Directors by express resolution. Notwithstanding the foregoing, however, a committee may not, under any circumstances: ... (vii) authorize or approve the reacquisition of Units, except according to a formula or method prescribed by the Directors ....

Considering section 5.6(b)(v) and section 5.16(vii) in conjunction, the court said it did not make sense that the directors could authorize the company to reacquire any member's or director's units without membership approval under section 5.16 but would need membership approval to acquire any of the directors' HES units—i.e., equity securities in HES—under section 5.6(b)(v). Thus, according to the court, “acquire” as used in section 5.6(b)(v) did not include a situation where HES “reacquires” its own units, and section 5.6(b)(v) thus did not require membership approval for the reacquisition of HES units.

Retterath attempted to argue that section 5.6(b)(v) was a specific provision whereas 5.16 was a general provision that did not limit 5.6(b)(v). He argued that section 5.6(b)(v) was specific because it was the only provision in the operating agreement that dictated how HES—through its directors—could acquire any equity security of a director and because section 5.6 was the only provision that specifically applied to the authority of the directors. In contrast, he characterized section 5.16 as just one of many provisions that applied to members generally.

The court rejected Retterath's argument for two reasons. First, the court said that other provisions of the operating agreement applied specifically to the authority of the directors—for example, provisions listing actions the directors were authorized to perform, allowing the directors to authorize one director to act as the agent of HES, and authorizing the directors to create committees. In addition, the court said that whether section 5.6(b)(v) was the only provision that specifically applied to the authority of the directors did not shed light on whether the actual language used in section 5.6(b)(v) required membership approval before HES could acquire a director's equity securities. Second, section 5.6(b)(v) and section 5.16 were both specific and general in their own right. The court pointed out that section 5.6(b)(v) addressed the directors' authority to acquire any equity securities of a director—i.e., of a specific member—and section 5.16 addressed the authority of a committee created by the directors to reacquire any member's units—i.e., a specific type of equity security. Thus, under Retterath's reasoning, different portions of each provision would control different portions of the other provision, which the court said did not make sense.

Retterath next argued that section 4.1, and impliedly section 5.6(a)(ii), of the operating agreement required membership approval of the MURA. Section 4.1 authorized the directors to make distributions “to the Unit Holders in proportion to Units held,” and section 5.6(a)(ii) prohibited the directors from “[k]nowingly engag[ing] in any act in contravention of this Agreement ..., except as otherwise provided in this Agreement” without unanimous consent of the members. Retterath argued that the two \$15 million payments to be made to him would be “liquidating distributions” and that such a distribution solely to him and not the other HES members in proportion to units held would violate section 4.1 and thus require unanimous member approval pursuant to section 5.6(a)(ii). But the court pointed out that section 4.1 specifically authorized the directors to “make distributions of Net Cash Flow.” The term “net cash flow” was defined in the operating agreement to mean:

the gross cash proceeds of the Company less the portion thereof used to pay or establish reserves for Company expenses, debt payments, capital improvements, replacements and contingencies, all as reasonably determined by the Directors. “Net Cash Flow” shall not be reduced by Depreciation, amortization, cost recovery

deductions or similar allowances, but shall be increased by any reductions of reserves previously established.

The court said that the funds HES was to use to pay Retterath for his units were not a distribution of HES's net cash flow. Furthermore, the court pointed to testimony of an attorney that "liquidating distribution" is a legal term used in the "tax code." The court stated that nothing in section 4.1 of the operating agreement or in any other provision of the agreement indicated that the term "distribution" was used in section 4.1 as a technical, legal term or that it included a specific, technical term used in tax law.

The court next considered whether public policy required membership approval of the MURA, either under Iowa common law or the Iowa Limited Liability Company Act. Retterath relied on section 489.407(3)(d)(3) of the Iowa LLC statute, which provides:

3. In a manager-managed limited liability company, all of the following rules apply:

....

d. The consent of all members is required to do any of the following:

....

(3) Undertake any other act outside the ordinary course of the company's activities.

Retterath argued that HES's actions regarding the MURA were outside the ordinary course of HES's activities. The court rejected this argument on the basis that Retterath waived the issue on appeal by failing to show what HES's ordinary course activities were or why the MURA related actions would have been outside HES's ordinary course actions. The court went on to state that, even if the issue was not waived, HES's operating agreement suggested actions related to a repurchase agreement were not outside HES's ordinary course of activities. As an example, the court pointed to the following purpose clause in the operating agreement:

The nature of the business and purposes of the Company are to: ... (iii) engage in any other business and *investment activity* in which an Iowa limited liability company may lawfully be engaged, as determined by the Directors. The Company has the power to do any and all acts necessary, appropriate, proper, advisable, incidental or convenient to, and in furtherance of, the purposes of the Company ....

(Emphasis added by the court.) The court compared repurchasing a member's units in the LLC to engaging in transactions for interest in an LLC, which is an investment activity in which an Iowa LLC may engage. The court also pointed to section 5.4 of the operating agreement, which detailed ways in which HES directors were permitted to engage in transactions. The court identified various subsections of section 5.4 that: (1) listed actions the directors were authorized to perform, including conducting HES's business, carrying on HES's operations, and having and exercising the powers granted by the Iowa LLC statute to effect the purposes for which HES was organized; (2) authorized directors to "[a]cquire by purchase, lease or otherwise ... personal property which may be necessary, convenient, or incidental to the accomplishment of the purposes of the Company"; (3) allowed directors to execute agreements and contracts in connection with the management, maintenance, and operation of HES's business and affairs; (4) permitted directors to carry out contracts necessary to, incidental to, or connected with the purposes of HES as may be lawfully performed by an LLC under Iowa law; and (5) authorized taking or not taking actions not expressly

prohibited or limited by the operating agreement or articles of organization to accomplish HES's purposes.

The intervening members also made an argument based on agency principles, the operating agreement, and section 489.110 of the Iowa LLC statute. Section 489.110 provides as follows:

The operating agreement may specify the method by which a specific act or transaction that would otherwise violate the duty of loyalty may be authorized or ratified by one or more disinterested and independent persons after full disclosure of all material facts.

The intervenors characterized the directors' action causing HES to acquire a director's equity securities in HES as insider- or self-dealing, and thus a breach of the duty of loyalty. Although the board ratified the chairman's execution of the MURA a few days after the chairman signed the MURA on behalf of HES, the intervenors argued that membership approval was required because only a principal can ratify the unauthorized act of an agent under Iowa law. The intervenors argued that section 5.6(b)(v)'s requirement of membership approval was the operating agreement's specified method of authorizing or ratifying the act that would otherwise violate the duty of loyalty. Thus, according to the intervenors, the principal was the membership rather than the board in this situation. The court rejected this argument based on its previous conclusion that the verb "acquire" in section 5.6(b)(v) did not include the verb "reacquire," and section 5.6(b)(v) thus did not apply to HES's "reacquisition" of a director's or affiliate's HES units. As a result, the court concluded that the board was not acting as an agent but rather as the principal.

The court next addressed whether the MURA was a valid and binding agreement. Retterath argued that the MURA was not binding because both parties had not signed the MURA by the June 13, 2013 deadline set forth in the MURA. The MURA contained the following provision: **"THIS AGREEMENT SHALL NO LONGER BE A BINDING OFFER AND SHALL BE NULL AND VOID AND OF NO FURTHER EFFECT IF IT IS NOT FULLY SIGNED BY MEMBER AND DELIVERED TO THE COMPANY PRIOR TO 2:00 P.M. LOCAL TIME ON THURSDAY, JUNE 13, 2013."** The court found no merit in Retterath's argument because this provision expressly indicated the MURA deadline only applied to Retterath's signature and delivery, and nothing in that section of the agreement conditioned the effectiveness or availability of the MURA on execution or approval of the agreement by HES or its board by June 13.

After concluding that the MURA was a binding agreement, the court analyzed at some length whether HES was entitled to the remedy of specific performance against Retterath. In sum, the court concluded that HES was entitled to specific performance based on the lack of an adequate remedy at law and HES's good-faith performance of its obligations.

With respect to the lack of an adequate remedy at law, the court examined the following three factors: HES's ability to procure a suitable substitute, the difficulty of proving damages, and the likelihood of collecting an award of damages. Because of the uniqueness of Retterath's specific units, the court concluded that HES would be unable to "readily procure by the use of money a suitable substitute for the promised performance," and that factor thus weighed in favor of HES's contention that damages would not provide an adequate remedy for Retterath's breach. With respect to the difficulty of proving damages, the court concluded that the loss caused by the inability to redeem Retterath's units, to extinguish Retterath's appointment powers, and to remove Retterath as a member of HES could not be estimated with reasonable certainty. Thus, this factor also supported HES's contention that damages would not provide an adequate remedy. HES made no argument that it would not be able to collect a damages award from Retterath, and that factor thus weighed in favor



of the adequacy of damages and against specific performance. Based on its consideration of all three factors, the court concluded that HES did not have an adequate remedy at law for Retterath's breach of the MURA. The inadequacy of the remedy at law supported specific performance as a remedy.

The court then considered whether HES was precluded from obtaining specific performance by failing to act in good faith or failing to perform its obligations. The court reviewed the law and the evidence bearing on these issues and concluded that HES was excused from performance because Retterath repudiated the MURA. Furthermore, regardless of whether HES was excused by Retterath's repudiation, the court concluded that the record revealed HES was ready, willing, and able to perform its obligations and it attempted to do so.

The court next held that the district court did not err in rejecting Retterath's affirmative defenses of equitable estoppel, unilateral and mutual mistake, unclean hands, and substantive and procedural unconscionability. In connection with several of these defenses, Retterath argued that HES always intended, but did not disclose its intention, to allocate taxable income to him from the date of the scheduled closing through the scheduled second installment on July 1, 2014, without providing him any distributions to cover that tax liability. However, the court concluded that the record did not support Retterath's claim that HES always intended to improperly allocate him taxable income and entered into the MURA with that intention. The evidence supported HES's explanation that it did not develop that allocation plan until 2014. With respect to his mutual mistake argument, the court stated that "[o]n a spectrum, the resulting allocation of taxable income from the sale of Retterath's units is more like an assumption related to something collateral to the contract than one of the parties' foundational reasons for entering into the MURA." Retterath made various other arguments to the effect that provisions of the MURA were extortionate, harsh, oppressive, or heavy-handed, but the court rejected all of Retterath's arguments. The court could not say that HES used fraudulent or deceptive practices to procure Retterath's assent, and the court emphasized that Retterath was a sophisticated party who was represented and advised by counsel.

The court next turned to the issue of whether the MURA supported an award of attorney's fees against Retterath. HES relied on the following indemnification provision of the MURA in support of its claim for recovery of attorney's fees:

Member agrees to indemnify, defend and hold harmless the Company and its members, managers, officers, directors, employees and representatives from and against any and all claims, suits, losses, liabilities, costs, damages, expenses, including reasonable attorneys' fees and costs, arising, directly or indirectly, out of or resulting from: (i) any breach or material inaccuracy of any representation or warranty by Member contained in this Agreement; or (ii) failure by Member to perform his obligation under this Agreement.

The court discussed case law in which it had held that indemnification clauses that use the terms "indemnify" and "hold harmless" evidence the parties' intent to protect a party from claims brought by third parties and cannot be used to shift attorney fees between the parties "unless the language of the clause shows an intent to clearly and unambiguously shift the fees." Based on this case law, the court held that the indemnification provision did not clearly and unambiguously express Retterath's and HES's intent to shift the attorney fees HES incurred in this breach of contract action. HES attempted to distinguish the MURA from the case law relied upon by the court on the ground that there were no plausible scenarios where a third-party would bring an action against HES if Retterath breached the MURA, but the court rejected that contention, pointing to examples in which Retterath's breach of the MURA could result in a third-party action against HES. Although

the court agreed with Retterath on this point and reversed the district court's award of attorney's fees against him, the supreme court rejected Retterath's argument that he was entitled to sanctions against HES for having sought attorney's fees under the indemnification provision.

*Behrend v. New Windsor Group, LLC*, 180 A.D.3d 636 (N.Y. App. Div. 2d 2020).

The appellate court affirmed the trial court's order that denied a putative assignee's motion for summary judgment in the assignee's action seeking a declaratory judgment that he held a membership interest in a New York LLC and an interest in the LLC's assets. The court held that the alleged assignment of the membership interest in the LLC was ineffective to make the assignee a member and that the effect of such an assignment was limited to entitling the assignee to receive the distributions and allocations of profits and losses to which the assignor would have been entitled prior to the assignor's resignation as member.

In April 2012, Julius Behrend sued New Windsor Group, LLC ("NWG"), Andrew Perkal as NWG's managing member, and Joseph Klein, seeking in part a declaratory judgment that he had a 50% membership interest in NWG and a 50% interest in certain NWG assets. Behrend's complaint included allegations that he had loaned to Klein more than \$2.5 million over the course of ten years and that, in December 2007, they entered into an agreement in which Klein agreed to assign his interest in NWG to Behrend. The complaint further alleged that NWG and Perkal (collectively, the "NWG Defendants") had refused to honor Behrend's membership interest in NWG or his interest in its assets. Klein did not appear in the case, but the NWG Defendants generally denied the allegations in their answer and asserted that whatever interest Klein may have had in NWG was transferred and extinguished prior to Behrend's suit. Behrend moved for summary judgment and included a "memorandum of understanding" between "Gmach Beth Joel-Julius Behrend" and Klein that was dated December 31, 2007, contained Klein's acknowledgment that he owed Behrend a certain amount of money, and documented their agreement for Klein to transfer his interest in NWG to Behrend.

In their cross-motion for summary judgment, the NWG Defendants submitted a copy of NWG's operating agreement that identified Perkal and his wife as the only members of NWG. Perkal stated in an affirmation that the NWG operating agreement was never amended and no new members were ever added. Perkal also stated that, prior to this action, Behrend did not contact him or claim that Klein had transferred his interest to him. Perkal explained that he had entered into an agreement with Klein to develop a shopping center owned by NWG and, under the terms of this agreement, Klein could eventually become a member. Klein, however, defaulted on that agreement, which resulted in arbitration, and he never became a member of NWG. The NWG Defendants also submitted evidence that, pursuant to an order of the same trial court confirming the arbitration award, Klein transferred any interest he had in NWG to Perkal and resigned as a member on April 26, 2012.

The trial court denied Behrend's motion for summary judgment, granted the NWG Defendants' cross-motion, declared that Behrend did not have a 50% membership interest in NWG or a 50% interest in any of its assets, and dismissed the remainder of the complaint. The trial court found that Behrend failed to establish that Klein transferred his interest in NWG to Behrend and that, at most, Klein had transferred only a security interest that was never perfected. Furthermore, the trial court determined that Behrend could have no interest in NWG's assets because a member does not have an interest in specific property of the LLC under the New York LLC statute. The court also found that it did not need to make a determination as to any membership interest Klein previously held in NWG because the evidence established that no assignment occurred in accordance with NWG's operating agreement and Klein had transferred whatever interest in NWG he had to Perkal in April 2012. Behrend appealed.

The appellate court began its analysis by reviewing the statutory provisions addressing the assignment of a membership interest and observed that an interest is assignable in whole or in part but such an assignment “does not . . . entitle the assignee to participate in the management and affairs of the [LLC] or to become or to exercise any rights or powers of a member.” N.Y. Ltd. Liab. Co. § 603(a)(1), (2). The court pointed out that the New York LLC statute provides “the only effect of an assignment of a membership interest is to entitle the assignee to receive, to the extent assigned, the distributions and allocations of profits and losses to which the assignor would be entitled.” N.Y. Ltd. Liab. Co. § 603(a)(3). The appellate court, however, also pointed out that a person can become a member of an LLC by assignment, but only where the operating agreement provides that the assignor-member has the power to grant the assignee the right to become a member and there is compliance with any conditions of that power. N.Y. Ltd. Liab. Co. § 602(b)(2).

Next, the court stated that the NWG operating agreement allowed a member to transfer the member’s membership interest, but “only with the prior unanimous consent of the other Members either in writing or at a meeting called for such purpose.” The court noted that the NWG Defendants supported their cross motion by submitting evidence that there had not been any prior unanimous consent allowing for the transfer of any membership interest to Behrend, and the court concluded that Behrend failed to raise a triable issue of fact on this issue. Thus, the court held that Klein’s alleged assignment of his membership interest in NWG to Behrend was ineffective to make Behrend a member. The court stated that the NWG Defendants had established that any interest Klein may have had in NWG was extinguished as of April 26, 2012, when he transferred that interest to Perkal and resigned as a member. As a result, the court held that, to the extent that Klein purportedly transferred his membership interest to Behrend, the effect of the assignment was limited to entitling Behrend to the distributions and allocations of profits and losses that Klein would have received from December 31, 2007, to April 26, 2012. Therefore, the appellate court agreed with the trial court’s order and affirmed.

***TMX Finance, LLC v. Goldsmith***, 833 S.E.2d 317 (Ga. Ct. App. 2019).

Two ousted members of a Georgia LLC brought a direct action against a third member and several of his entities, alleging that the defendants carried out a takeover scheme by causing a funding crisis. The court of appeals affirmed in part, holding that the ousted members could bring a direct action against the third member and stated claims for breach of the operating agreement, breach of fiduciary duty, and other claims.

Dr. Goldsmith, a neurologist who specialized in complex ear procedures, started ICOT Hearing Systems, LLC (“ICOT Hearing”) to provide low-cost hearing aids. Jason Jue became involved in the early stages of ICOT Hearing and assisted in building the company into a multimillion-dollar enterprise, running the day-to-day operations as its sole manager. ICOT Hearing was wholly owned by ICOT Holdings, LLC (“ICOT Holdings”). Prior to the events at issue in this case, Goldsmith and Jue together held a majority interest in ICOT Holdings and controlled ICOT Hearing and ICOT Holding (collectively, “ICOT”).

In August 2015, Young began personally lending money to ICOT. Goldsmith, Jue, and Young shared the goal of selling ICOT to a third party for upwards of “hundreds of millions of dollars in the near term.” Young encouraged Jue to “put his foot on the gas” regarding ICOT operations and assured Jue and Goldsmith that he would provide more funding.

In March 2016, ICOT Hearing, ICOT Holdings, Jue, Goldsmith, Young, and Young’s limited liability company, TY ICOT Investments (“TY Investments”), entered into a restructuring agreement under which Young loaned additional funds to ICOT Hearing and guaranteed two bank loans (the “Restructuring Agreement”). As part of the restructuring, TY Investments purchased membership

units in ICOT Holdings from Goldsmith and minority members and obtained exclusive one-year options to purchase additional units from Goldsmith and minority members. TY Investments' purchase and its options were memorialized in a Membership Interest and Purchase Option Agreement entered at the time of the restructuring of ICOT Holdings (the "Goldsmith Agreement"). As an additional part of the restructuring, ICOT Holdings and its members executed an Amended and Restated Operating Agreement (the "Operating Agreement"), which contained provisions placing certain duties on the company's managers, including the duties to conduct the business in good faith, to not engage in wrongful conduct, and to act in a manner that would not result in improper personal benefit to the managers. The Operating Agreement also provided to TY Investments the power to appoint one of three managers to ICOT Holdings' board of managers. TY Investments then appointed Young, who agreed to comply with the terms of the Operating Agreement while serving in that position. Following the restructuring and prior to execution of the options, Jue and Goldsmith retained their controlling interest in ICOT Holdings. On the other hand, if TY Investments had executed all of the options it acquired as a result of the restructuring, then Young, through TY Investments, would have a majority interest in ICOT Holdings.

In March 2017, Goldsmith and Jue filed a direct action against Young and TY Investments (collectively, the "Young Defendants") and against other entities controlled by Young. The plaintiffs' amended complaint included claims for breach of the Operating Agreement and breach of fiduciary duties.

The complaint alleged that, after the restructuring, Young orchestrated the following takeover scheme in order to obtain a controlling interest in ICOT Holdings without having to exercise the options: (1) caused an "existential funding crisis" by derailing funding from third-party capital providers; (2) refused to sign the guarantee for a previously negotiated line-of-credit unless he received warrants from Goldsmith and Jue, resulting in short-term cash flow problems; (3) drove away a third-party buyer with statements that put the company's financial health in a poor light, disparaged Jue, and threatened to dilute the membership interests of Goldsmith and Jue; (4) initiated an inspection of ICOT's books and records in preparation for the takeover; (5) leveraged the funding crisis to control ICOT Holdings' board of managers by appointing an ally, misrepresenting that ally's appointment was necessary for ICOT Holdings to draw on the line-of-credit; (6) coordinated vote with the ally to terminate Jue as manager of ICOT Hearing; and (7) diluted Goldsmith and Jue and obtained majority control by issuing a capital call when he knew that the line-of-credit was available and that the plaintiffs lacked the funds to make a pro rata contribution pro rata. After Young took control of ICOT Holdings, he contacted the same third-party buyer and proposed a discounted sale. Considering their diluted position and the discounted sale price, neither Goldsmith nor Jue would receive money from the sale. The defendants answered and later moved to dismiss, contending that the plaintiffs were not entitled to bring a direct claim and had failed to state any viable claims against them. The trial court denied the defendants' respective motions. The defendants filed applications for interlocutory appeal, which the court granted, leading to the present companion appeals.

The Young Defendants contended that the plaintiffs failed to state a claim for breach of the ICOT Holdings' Operating Agreement and breach of fiduciary duties. Specifically, the Young Defendants maintained that neither Young's failure to provide additional funding beyond what was previously loaned and guaranteed under the Restructuring Agreement nor his vote for a capital call that led to dilution could support a claim for breach of the Operating Agreement or breach of fiduciary duty. The court cited the Georgia LLC Act and case law for the proposition that the managing members of an LLC owe fiduciary duties to the company and its members, but such fiduciary duties may be modified or eliminated by the operating agreement. Under the Operating Agreement, managers were required to act in good faith, refrain from intentional misconduct, and

avoid any improper personal benefits. The court disagreed with the Young Defendants, reasoning that Young (1) derailed additional funding from third-party capital providers solely to implement his takeover scheme; (2) refused to sign the line-of-credit guarantee solely to create a funding crisis; (3) made false representations to a prospective third-party buyer so as to delay any sale and increase his leverage over the plaintiffs; and (4) made false representations to Jue about the provider of the line-of-credit requiring the ally's appointment to ICOT Holdings' board of managers and orchestrating the capital call for the sole purpose of ousting the plaintiffs from control. Therefore, the court concluded that the complaint asserted that Young had acted in bad faith, had engaged in intentional wrongful conduct, and had acted for the purpose of obtaining an improper personal benefit.

***Tangas v. International House of Pancakes LLC***, 779 F. App'x 317 (6th Cir. 2019).

The court of appeals reversed the district court's summary judgment in favor of a Delaware LLC and its parent corporation on the indemnification claims of a former employee of the LLC. The court held that the employee's rights vested under the LLC operating agreement before her termination; the business judgment rule did not apply to the LLC's determination that the employee's conduct amounted to fraud, willful misconduct, and bad faith; and genuine issues of material fact existed with respect to the employee's claims that she was entitled to indemnification under the parent corporation's bylaws and the LLC operating agreement.

Autumn Lee Tangas worked for International House of Pancakes, LLC ("IHOP"), a Delaware LLC, for more than two decades and eventually became a "franchise bureau consultant." In that role, Tangas acted as a liaison between IHOP and franchisees to help franchisees improve profits and ensure that they adhered to IHOP operating standards. In 2004, Tangas and her domestic partner were involved in a financial transaction with a franchisee known as Terry Elk, whose operations Tangas oversaw. The purpose of the transaction was unclear, and eventually the money that was exchanged was returned. Years later, in 2011, the FBI raided Elk's IHOP operations and questioned Tangas. The same day, Tangas informed the in-house counsel of IHOP's parent company, DineEquity, Inc., a Delaware corporation, about the interview with the FBI even though agents asked her not to discuss the conversation. In 2012, DineEquity's in-house counsel communicated to Tangas's lawyer that Tangas was obligated to cooperate with IHOP's 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 Elk, Tangas, and others. The indictment, which charged Tangas with money laundering and hiring undocumented workers at Elk's IHOP locations, essentially alleged that Tangas used her position as a franchise bureau consultant to hide Elk'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 and DineEquity pay these legal fees. The companies refused to pay, and Tangas sued on the basis that DineEquity's bylaws and IHOP's LLC agreement entitled her to indemnification. The district court granted summary judgment in favor of DineEquity and IHOP, holding that Tangas was not entitled to indemnification under DineEquity's bylaws or IHOP's LLC agreement and that IHOP's decisions were protected by the business judgment rule. The court of appeals disagreed with the district court's interpretation of the bylaws and LLC agreement and concluded that there were genuine issues of material fact regarding Tangas's conduct that affected her rights under the governing documents. Thus, the court of appeals vacated the summary judgment and remanded.

The court of appeals first addressed the indemnification provision of DineEquity's bylaws, which provided that DineEquity:

**shall indemnify any person** who was or is a party or is threatened to be made a party to **any threatened, pending** or completed action, suit or proceeding, whether civil, **criminal**, administrative or investigative (other than an action by or in the right of the Corporation) by reason of the fact that 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, against expenses (**including attorneys' fees**) judgments, fines and amounts paid in settlement actually and reasonably incurred by him in connection with such action, suit or proceeding **if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the Corporation**, and, with respect to any criminal action or proceeding, had no reasonable cause to believe his conduct was unlawful.

(Emphasis added by the court.)

The court of appeals disagreed with the district court's conclusion that "'an employee of a subsidiary company serves 'at the request of' its parent company only when the parent company appoints the employee to a specific position'" and concluded that there were factual disputes as to whether Tangas was serving IHOP at the request of DineEquity. Additionally, the court concluded that a trier of fact must determine whether Tangas acted in good faith. The court noted that the Delaware corporate indemnification statute articulates a policy favoring indemnity of former officers and directors and that Delaware courts have consistently held that dismissal of criminal charges is by definition success on the merits. However, the court pointed out that this case involved contractual indemnification rather than statutory rights. On remand, the district court would have to conduct a trial to assess whether Tangas was serving IHOP at the request of DineEquity as well as whether she acted in good faith.

The court next turned to the indemnification provision of the IHOP LLC agreement, which provided as follows:

**To the fullest extent permitted by law**, 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** or (ii) any Claim initiated by such Covered Person unless such Claim (or part thereof) (A) was brought to enforce such Covered Person's rights to indemnification hereunder or (B) was authorized or consented to by the Member. Expenses incurred by a Covered Person in defending any Claim shall be paid by the

Company in advance of the final disposition of such Claim upon receipt by the Company of an undertaking by or on behalf of such Covered Person to repay such amount if it shall be ultimately determined that such Covered Person is not entitled to be indemnified by the Company as authorized by this Section 8.2.

(Emphasis added by the court.) The agreement defined a “Covered Person” as “the Member, or any officers, directors, stockholders, partners, **employees**, affiliates, representatives or agents of any of the Member, nor any officer, employee, representative or agent of the Company” (emphasis added by the court). The parties agreed that Tangas was a “Covered Person” until she was terminated, but IHOP argued that she was no longer entitled to indemnity after she was fired.

Because most of Tangas’s legal fees were incurred after her termination, a significant issue bearing on the application of the LLC agreement was whether the indemnification provision included “terminated” or “former” employees. The court discussed this issue but concluded that it was not dispositive because the court concluded that Tangas’s rights vested before her termination. Unlike DineEquity’s bylaws, the LLC agreement did not say anything about “current” versus “former” employees. The court concluded that the district court erred in concluding that the absence of a modifier in the list of “Covered Persons” suggested only current employees were eligible for indemnity and stated that any ambiguity in this regard should be construed against the drafter. The court characterized the question of whether the LLC contemplated indemnity for former employees as a “close one,” but thought the more logical conclusion was that former employees were included in an ambiguous LLC agreement for the policy reasons articulated in Delaware (corporate) statutory and case law. Ultimately, the court stated that it need not resolve the issue in light of its conclusion (discussed below) that Tangas’s rights vested before her termination, but the court made the point that it did not agree with the district court’s method of resolving the issue by comparing DineEquity’s bylaws to IHOP’s LLC agreement. Characterizing the documents as independent, the court did not think that the clearer document informed the more ambiguous.

In concluding that Tangas’s rights to indemnification vested before her employment was terminated, the appellate court relied on two cases distinguished by the district court—*Branin v. Stein Roe Inv. Counsel, LLC*, No. 8481–VCN, 2014 WL 2961084 (Del. Ch. June 30, 2014), and *Salaman v. National Media Corp.*, No. 92C–01–161, 1992 WL 808095 (Del. Super. Ct. Oct. 8, 1992). The court of appeals acknowledged that “[i]t is true that these cases do not announce that all indemnity provisions everywhere function as rights that vest,” but the court went on to explain that “corporations offering indemnity rights are bound to deliver that benefit when a covered person is targeted, presuming of course that the employee acted in good faith. Otherwise, a corporation could simply fire anyone under investigation, rendering indemnity provisions a nullity. This inequity is exactly what Delaware law guards against. When the FBI came to Tangas’s door, her indemnity rights vested because the LLC Agreement is written expansively to contemplate coverage for threatened and investigative actions. Indemnity is designed for precisely this situation when an employee is sued and is later found not guilty or not liable. The distinction between ‘former’ and ‘current’ employees is irrelevant because Tangas’s rights vested under the Agreement when the FBI began investigating her and before IHOP fired her.”

The court next addressed IHOP’s argument that Tangas’s bad conduct barred her indemnification claim even if she was entitled to indemnification under the LLC agreement. IHOP argued that Tangas’s failure to report the financial transaction with Elk in 2004 and her failure to cooperate in the internal IHOP investigation in 2011 and 2012 amounted to fraud, willful misconduct, and bad faith under the LLC agreement and that IHOP was entitled to deference on its determination that Tangas engaged in these activities. In its summary judgment ruling, the district

court applied the business judgment rule to conclude that no reasonable jury could challenge IHOP's decision, but the court of appeals rejected the notion that the business judgment rule applied to IHOP's determination that Tangas was not entitled to indemnification. The court explained that "the business judgment rule is irrelevant to this case because there is no decision over which a corporation's board could exercise its business judgment. A legal question of contract interpretation is not within a board's purview." The court stated that "[t]he business judgment rule might be relevant in an indemnity context if the bylaws or operating agreement make indemnity discretionary. That is not true here because the drafter of the LLC Agreement employed the word 'shall.'"

Finally, IHOP argued that Tangas was not entitled to indemnity, even if the business judgment rule did not apply, because she broke the rules with regard to the Elk transaction and failed to cooperate with management in 2011 and 2012. However, both of these issues were hotly disputed by the parties, and the court concluded that a trial on the issue of Tangas's good faith was necessary. The court stated that some case law suggests that expansive contractual language and dismissal of the criminal charges and lack of underlying criminal liability would render the indemnitee's state of mind irrelevant, but other authority concludes otherwise. Ultimately, the court held that "IHOP is not entitled to deference on the good faith question because its indemnification procedures are directive and broad. But holding that the dismissal of Tangas's charges satisfies the good faith provision would render the provision of the LLC Agreement discussing misconduct a nullity. Thus, a trial is necessary."

*Namerow v. PediatriCare Associates, LLC*, 218 A.3d 839 (N.J. Ch. Div. 2018).

A retired member brought an action against a New Jersey LLC and its three active members alleging various claims, including modification of the operating agreement by conduct, minority member oppression, and breach of fiduciary duties. The trial court granted summary judgment in favor of the LLC and its active members, holding that (1) the parties' course of conduct over a sixteen-year period did not modify the operating agreement; (2) the economic loss doctrine barred the retired member from recovering damages based on a claim of minority member oppression; and (3) there was nothing to suggest that the active members breached any fiduciary duty owed to the retired member.

In January 2000, four doctors, Namerow, Zucker, Bienstock, and Chism entered into an operating agreement to form PediatriCare Associates, LLC, a New Jersey limited liability company, for the purpose of owning and operating a medical practice. In March 2001, the parties entered into an Amended and Restated Operating Agreement (the "Agreement"). The Agreement provided members with the right to retire once they had reached the age of sixty and had provided twenty-five years of membership or service to the practice. Furthermore, the Agreement prescribed that the "retirement purchase price" of a retiring member's interest was calculated according to Section 10 of the Agreement (titled "Determination of Value") as follows:

The total value of the company ("company value") shall be the last dated amount set forth on the Certificate of Agreed Value, attached hereto as Exhibit G and made part hereto, executed by the members. The members shall exercise their best efforts to meet not less than once per year for the purpose of considering a new value but their failure to meet or determine a value shall not invalidate the most recently executed Certificate of Agreed Value setting forth the company value then in effect. If the parties fail to agree on a revaluation as described above for more than two (2) years, the company value shall be equal to the last agreed upon value, adjusted to reflect the increase or decrease in the net worth of the company, including collectible accounts



receivable, since the last agreed upon value. The value of a member's interest ("Value") shall mean the company value multiplied by the percentage interest held by said member and being purchased hereunder, less any indebtedness that the selling or disabled member, the Decedent, or a member departing for any other reason contemplated hereunder may have to the company or to the other members, whichever the case may be.

The most recent Certificate of Agreed Value attached to the Agreement, which stated that the "value of the company" was \$2.4 million, was dated January 1, 2000 and signed by Namerow, Zucker, Bienstock, and Chism.

Namerow announced his intention to retire in January 2016, which triggered the application of Section 10. Over the next several months, the parties obtained two appraisals, each using the fair market valuation methodology, for the purpose of reaching a settlement regarding the voluntary negotiated buyout number. No such number was ever reached and the Agreement was never amended.

Namerow filed this action on October 10, 2017 against Zucker, Bienstock, and Chism (collectively, the "Active Members") and the LLC, asserting claims for modification of the Agreement by conduct, oppression of a minority member, and breach of fiduciary duty. Both sides filed motions for partial summary judgment.

The first issue that the trial court addressed was whether the parties' course of conduct over a sixteen-year period modified the terms of the Agreement to require use of a fair market valuation, rather than a net worth valuation as required by Section 10, to value the practice. Namerow argued that the parties had modified the Agreement because they had ignored Section 10 on three prior occasions. The trial court was not persuaded and reasoned that there was no indication that the parties intended to informally modify Section 10 because one such occasion was wholly unrelated to the retirement buyout purchase price of a member and, based on this litigation, the other two occasions did not settle the disagreement. The court then noted that the Agreement stated that it can only be modified by a vote of 80% of the membership interests and there was no evidence that Namerow or the Active Members agreed to formally modify Section 10. Therefore, the trial court granted summary judgment in favor of the LLC and the Active Members on Namerow's claim that the parties' conduct modified Section 10 to require the use of a fair market valuation methodology to determine his retirement purchase price.

Next, the trial court addressed Namerow's claim of minority member oppression under the New Jersey Revised Uniform Limited Liability Company Act (the "New Jersey LLC Act"). Under the New Jersey LLC Act, judicial recourse is available to minority members who have been "oppressed" by the majority members. New Jersey case law defines "oppression" as "frustrating a [member's] reasonable expectations" and "is usually directed at a minority [member] personally[.]" Thus, a minority member has a genuine claim for oppression under the New Jersey LLC Act when their reasonable expectations have been frustrated by the majority members. According to Namerow, he had a reasonable expectation that his 25% membership interest would be purchased using a fair market valuation methodology. In further support of his oppression claim, Namerow referenced an earlier ruling from the court in which it denied the defendants' motion to dismiss because, at that time, his expectation was reasonable. The trial court pointed out that its earlier ruling was made at a preliminary stage in the litigation and, after discovery and the court's determination that the net worth methodology applied, it was clear that the defendants' conduct did not support a claim for oppression under the New Jersey LLC Act. Furthermore, the court cited New Jersey case law for the proposition that the economic loss doctrine prohibits plaintiffs from recovering in tort economic

losses to which their entitlement only flows from a contract. Because this claim was contractual in nature and Namerow's entitlement flowed from the Agreement, the trial court held that his minority member oppression claim failed as a matter of law because it was barred by the economic loss doctrine.

The third issue that the trial court addressed was whether the defendants breached the fiduciary duties owed to Namerow. Under the New Jersey LLC Act, each member of a member-managed LLC owes the company and the other members a duty of care. The court observed that Namerow's claim for breach of fiduciary duty was based on many of the same recycled allegations from his other claims and were unconvincing for the same reasons. The trial court further reasoned that there was no valid claim for breach of fiduciary duty based on the members of a member-managed LLC acting in conformity with the Agreement. Thus, the trial court granted summary judgment in favor of the LLC and the Active Members on Namerow's claim for breach of fiduciary duty.

### **Buyout of Member's Interest**

*Wilson v. Gandis*, 844 S.E.2d 631 (S.C. 2020).

The South Carolina Supreme Court affirmed the trial court's finding that two members owning 55% of the membership of an LLC oppressed the remaining member pursuant to a "tightly controlled cabal to oust [the minority member] that could serve as a script for minority oppression." The court rejected the majority members' argument that they were protected from personal liability for their actions by the South Carolina LLC statute, but held that the majority members would only be required to perform the equitable remedy of a buyout of the minority member's interest if the LLC failed to do so. Further, the court held that the members of the majority faction (a 45% member and a 10% member) should only be liable for their proportional shares of the buyout price rather than having joint and several liability.

David Wilson, John Gandis, and Andrea Comeau-Shirley were members of Carolina Custom Converting, LLC (CCC). CCC was formed by Gandis and Wilson in 2007 as a manager-managed LLC with each owning a 50% membership interest. Gandis served as president and manager, and Wilson served as vice-president. No formal operating agreement was ever executed for CCC, but Wilson and Gandis memorialized many of their oral agreements through emails and a questionnaire they completed with the intent to create an operating agreement. Neither signed noncompete, nondisclosure, or non-solicitation of employee(s) agreements. When CCC was formed, Wilson owned and operated Eastern Film Solutions (EFS), which bought and sold synthetic and metalized films. Gandis owned and operated DecoTex, which bought and sold decorative designs for vinyl film. Wilson and Gandis initially agreed that CCC would perforate and slit film. Wilson agreed to run some of EFS's slitting business through CCC.

In 2008, Wilson and Gandis discussed winding down their individual businesses and expanding CCC's operation. Wilson agreed that CCC would become a buyer and seller of film for one of EFS's major accounts, which would result in significant additional revenue for CCC. Additional discussions between Gandis and Wilson regarding Wilson's winding down EFS and running all future film business through CCC occurred throughout 2008. Wilson advised Gandis that Wilson intended to keep three import accounts separate from CCC. In exchange for transferring EFS's accounts to CCC, Wilson received \$8,000 (later increased to \$12,000) per month. After the expansion of CCC, Gandis managed operations and Wilson led CCC's sales efforts. Wilson completed the winding down process of EFS in 2009. Gandis continued to own and operate his own decorative design vinyl business DecoTex. Gandis agreed to fund CCC through credit lines from

DecoTex and his other business M-Tech. CCC also operated out of a building owned by M-Tech, for which Gandis received the benefit of rent payments made by CCC.

In 2008, Gandis engaged Shirley, a CPA, to provide CCC with accounting and formation advice. In 2009, Gandis and Wilson each transferred a 5% interest in CCC to Shirley in exchange for her services. Shirley did not have a formal voting interest, but she took an active role in managing CCC and provided extensive personal counsel to Gandis about his operation of CCC.

CCC's business grew, and CCC posted a profit of over \$1,000,000 in 2010. From the time CCC was formed in 2007 through 2010, CCC reserved funds for the members to cover their individual tax liabilities. Although CCC had an operating loss in 2011, the high profits from 2010 combined with excess inventory created phantom income for the members, and the leaner revenue from 2011 resulted in a shortfall for the planned 2010 tax distributions. The court described private email exchanges between Gandis and Shirley in early 2011 in which Shirley urged Gandis to use funds set aside by CCC for its members' 2010 tax liability to pay off CCC's obligation on the M-Tech line of credit rather than distributing the funds to cover their income tax liability as had been the customary practice. In one email to Gandis, Shirley stated, "What I want to do is to keep the cash balance [of CCC] relatively low ... so we don't get a request around tax time [from Wilson] to 'distribute' any extra money ... instead ... it will already have been used to repay debt. Which is a better use!" She advised Gandis to use the M-Tech line of credit to pay his own taxes, which Gandis did, and Shirley told Wilson by email on April 15, 2011, that no distributions would be made to CCC members to cover tax liability. Shirley and Gandis also began secretly monitoring Wilson's emails, and trial testimony and emails between Shirley and Gandis revealed their plans to take various actions calculated to benefit Gandis and Shirley and disadvantage Wilson with the ultimate goal of excluding Wilson from the business.

The trial court summarized the following oppressive and unfairly prejudicial acts of Gandis and Shirley from 2010-2012: (1) initiating an "exit strategy" for Wilson; (2) threatening to stop Wilson's agreed-upon and guaranteed monthly payments unless he relinquished his membership interest and became an at-will employee with a noncompete agreement; (3) refusing to make a tax distribution to Wilson while setting aside the funds for a distribution to pay off a line of credit so Gandis could borrow against that line to pay his own taxes; (4) monitoring all of Wilson's private emails, including those with his wife, his attorney, and his accountant; (5) withholding Wilson's agreed-upon and guaranteed monthly distributions in January 2012; (6) making representations that Wilson may not receive distributions for two years; (7) managing the money supply to make it appear as if cash was more limited than it was in actuality; (8) continually making unilateral changes, including secretly back-paying rent at a higher rate than agreed upon and transferring assets, e.g., an air conditioner, to Gandis's entities by expensing such items as rent; (9) limiting Wilson's access to CCC's financial information; (10) removing Wilson from signatory authority on CCC's operating account; (11) removing Wilson's ability to make wire transfers for CCC; (12) excluding Wilson from discussions about CCC's business operations; (13) manipulating the December 2011 "Pro-Forma Balance Sheet" to devalue Wilson's interest in CCC; (14) physically locking Wilson out of his company and refusing to allow him to return; (15) demanding possession of Wilson's laptops and Blackberry; (16) terminating the cell phone plans for Wilson and his family while maintaining coverage for the other members; (17) terminating health insurance coverage for Wilson and his family; and (18) forming a company to compete with CCC in order to siphon profits until Wilson caught them.

Wilson filed suit against Gandis and Shirley in 2012 alleging several causes of action. Wilson later sued CCC, and CCC sued Wilson and his subsequent employers.

The Supreme Court of South Carolina began its discussion of minority member oppression by noting that the South Carolina Uniform Limited Liability Company Act provides that “[a] member or manager may maintain an action against a limited liability company or another member or manager for legal or equitable relief” to enforce the member’s statutory rights under the Uniform Limited Liability Company Act of 1996 (the LLC Act), the member’s rights under an operating agreement, and “the rights that otherwise protect the interests of the member.” S.C. Code Ann. § 33-44-410(a). The comment to that section provides that there is “broad judicial discretion to fashion appropriate legal remedies.” If a member establishes that “the managers or members in control of the company have acted, are acting, or will act in a manner that is unlawful, oppressive, fraudulent, or unfairly prejudicial” to the member, a court may dissolve the limited liability company. S.C. Code Ann. § 33-44-801(4)(e). The comment to that section provides “the court has the discretion to order relief other than the dissolution of the company... includ[ing] ... the purchase of the distributional interest of the applicant.” S.C. Code Ann. § 33-44-801 cmt. The court cited and discussed minority shareholder oppression cases involving closely held corporations and stated that the considerations in those cases also apply to a claim for oppression made by a minority member of an LLC.

The supreme court agreed with the trial court’s characterization of Gandis’s and Shirley’s efforts as a “tightly controlled cabal to oust Mr. Wilson [that] could serve as a script for minority [ ] oppression.” The court said that the record was replete with evidence of “freeze out” maneuvers on the part of Gandis and Shirley. The emails revealed a calculated, step-by-step scheme to oust Wilson and relegate him to either a former owner or an employee bound by a noncompete agreement. Shirley even stated to Gandis “we will freeze his capital account and provide that he will be paid out ONLY when the LLC has made distributions to you in excess of your guaranteed payment (and your tax liability),” and that “might mean that [Wilson] sits with a frozen capital account until the LLC liquidates (and he will still have a 2010 tax bill that he has to pay).”

Gandis and Shirley argued that the court erred in determining that they oppressed Wilson because of Wilson’s “unclean hands” and that their actions were not oppressive because they were not motivated to shut Wilson out, but to provide Wilson with options to remain a member of CCC while satisfying his tax liability. The court rejected these arguments and stated that the evidence in the record showed to the contrary. The court also rejected Gandis’s and Shirley’s argument that their actions were protected by the business judgment rule because the rule only applies “absent a showing of a lack of good faith, fraud, self-dealing or unconscionable conduct.” The court agreed completely with the trial court’s conclusion that “[t]he record—particularly the remarkable emails between Gandis and Shirley—abounds with evidence of calculated oppression.”

The court then addressed Gandis’s and Shirley’s argument that the trial court took an extreme and legally unsupported step by holding them personally liable for the alleged oppression of Wilson. Gandis and Shirley contended that the LLC Act protects members from personal liability taken in the ordinary course of business. The court agreed that the LLC Act typically provides personal liability protection, but the court rejected the argument that an LLC member who commits acts of “calculated oppression” against another member has acted in the ordinary course of business of the LLC.

The court granted Gandis and Shirley partial relief by ordering that CCC was primarily responsible for purchasing Wilson’s interest and that Gandis and Shirley were only personally obligated to buy out Wilson’s interest if CCC failed to do so. The court also held that Shirley and Gandis should not be jointly and severally liable for the entire purchase price. Shirley argued, and Gandis agreed, that Shirley’s responsibility to purchase any portion of Wilson’s interest should be limited to the proportion her interest in CCC bears to the entire obligation to purchase. The court agreed but stated in a footnote that it was not foreclosing the possibility that an LLC member who

acts to oppress another member can be held liable for an amount greater than his or her proportional interest in the LLC.

The court briefly discussed the claim of Gandis and Shirley against Wilson for breach of fiduciary duty. Gandis and Shirley alleged in their counterclaim that Wilson breached fiduciary duties owed to CCC and to them by (1) usurping CCC's business opportunities with customers from EFS and engaging in secretive side deals; (2) misappropriating CCC's alleged trade secrets and confidential information; and (3) destroying evidence on CCC's laptops and Blackberry. Because CCC would have sustained any financial loss caused by Wilson's alleged actions, the court held that Gandis and Shirley lacked standing to bring a breach-of-fiduciary-duty claim in their individual capacities. On the merits, the court found that the trial court correctly concluded Wilson did not breach any fiduciary duties owed to Gandis and Shirley.

The court next addressed the valuation of Wilson's distributional interest in CCC and the date of valuation. Gandis and Shirley argued that an incorrect method of valuation was applied and resulted in a windfall for Wilson. The court rejected this argument, relying on S.C. Code Ann. 33-44-701(e), which provides the mechanism for determining fair value of a member's distributional interest when it is being purchased by the company. The court held that the same approach should be applied when individual members are ordered to buy the distributional interest. As for the date of valuation, the court noted that there is little authority regarding the appropriate date for valuation, but the court cited case law stating that the date of ouster seems to be an appropriate date for valuation in cases of minority shareholder oppression. Wilson's expert valued CCC's total equity at \$1,018,753 and Wilson's interest at \$408,335 as of December 31, 2011. She valued Wilson's interest at \$233,776 as of December 31, 2013. The trial court's appointed expert and the defendants' expert testified of possible adjustments to the value of CCC due to equipment moving costs, excess inventory, and advances. The trial court noted that CCC, Gandis, and Shirley failed to present evidence of CCC's then-current financial condition at the time of trial. The court found the December 31, 2011 valuation of Wilson's expert credible but applied the three downward adjustments of the defendants' expert to calculate the value of Wilson's interest as of that date. The supreme court agreed with the trial court's valuation, holding that the most equitable valuation date was December 31, 2011 for several reasons. First, as noted by the trial court, CCC, Gandis, and Shirley failed to present evidence of CCC's then-current financial condition during the 2014 trial, partly because CCC failed to file tax returns for the 2012 and 2013 tax years. Second, Gandis and Shirley initiated an exit strategy and ousted Wilson in January 2012. Thus, valuing CCC and Wilson's interest in CCC as of December 31, 2011, provided an accurate value of CCC when Wilson was an active member of CCC with an opportunity to impact CCC's financial condition. On the other hand, the court stated that December 31, 2013, was an inappropriate valuation date because Gandis and Shirley ousted Wilson in January 2012 and prevented Wilson from participating in any CCC business decisions or operations that impacted CCC's value after January 2012.

Finally, the court addressed CCC's claim that Wilson and his subsequent employers misappropriated CCC's trade secrets. CCC claimed that it spent significant time and resources developing its customer and supplier contact lists, electronic vendor reference program, and inventory reference program, and that all of this information was CCC trade secrets. The court agreed with the trial court's determination that the information CCC claimed as trade secrets lacked independent economic value. Without independent economic value there can be no trade secret, and CCC's claim for misappropriation failed.

*Benjamin v. Bierman*, 943 N.W.2d 283 (Neb. 2020).

In an action by a deceased member's personal representative seeking judicially ordered dissolution of two LLCs and asserting breach of contract by the surviving members based on their failure to buy out the deceased member's interests, the Nebraska Supreme Court held that the personal representative lacked standing to seek dissolution of LLCs because she was not a member. With respect to the breach-of-contract claim, the court held that the operating agreements' repurchase provisions required a determination of fair market value of the deceased member's interest by agreement of the parties or, absent agreement, by an independent appraiser, and the trial court did not clearly err in its findings regarding the actions taken in connection with the appraisal and buyout process, including its finding that the surviving members failed to negotiate in good faith and breached the operating agreements.

Mark Benjamin owned a one-half interest in Sixth Street Rentals, LLC ("Rentals") along with Doug Bierman and a one-third interest in Sixth Street Development, LLC ("Development") along with Doug Bierman and Doug's father, Eugene Bierman. Mark passed away on April 14, 2015, leaving his wife Brenda Benjamin as his primary beneficiary and the personal representative of his estate. Prior to his death, Mark was acting manager of both LLCs. After Mark's death, Doug took over the manager position for both LLCs.

Counsel for both Rentals and Development sent notices to Brenda pursuant to the respective separate but identical operating agreements, stating the LLCs' intention to buy Mark's interests. Brenda testified at trial that she and Doug had generally reached an agreement pursuant to which Doug would buy out Mark's interest in Rentals, and Doug and Eugene would buy out Mark's interest in Development. Brenda would receive Development's interest in a store facility jointly owned by Development, a third party, and Mark's estate as an offset for the purchase price for Mark's interest in Development.

The parties agreed to close on the buyouts of Mark's interests in Rentals and Development as well as a corporation in which Mark owned shares on April 15, 2016. The parties had valuations done on Rentals and Development by Terry Galloway. The parties did not close on the specified date, and Brenda sued the Biermans and the LLCs on June 1, 2016. After a bench trial, the trial court found that the Biermans, Rentals, and Development had breached the operating agreements of Rentals and Development, ordered an accounting for each company, declined to dissolve either, and awarded Brenda damages.

Brenda appealed the trial court's decision not to order dissolution of both Rentals and Development. The Biermans, Rentals, and Development (collectively, the "Bierman parties") cross-appealed alleging numerous points of error. The court grouped the Bierman parties' points of error into the following categories: assignments of error related to fair market value, assignments of error related to breach of contract and specific performance, and remaining assignments of error.

After concluding that Brenda lacked standing to seek judicial dissolution of Rentals and Development because she was not a member of the LLCs, the court turned to the numerous points of error brought by the Bierman parties on cross-appeal. The primary arguments centered around the fair market value of Rentals and Development. The Bierman parties argued that the operating agreement did not set forth an unambiguous method for determining the fair market value of Rentals and Development. Brenda argued that the operating agreements were clear in setting out fair market value determinations by either allowing the parties to agree to fair market value or, absent agreement, to appoint an independent third-party appraiser.

The relevant language of the operating agreement stated:

In the event that a Member dies..., the Company may at its option repurchase the deceased...Member's interest in the Company for an amount equal to the fair market value of such interest on the Member's date of death... The fair market value of the Member's interest shall be as agreed in good faith by the Company and the personal representative(s) of the deceased Member's estate...; provided that if no such agreement has been reached within ninety (90) days of the date of death..., then the fair market value shall be determined by an independent and duly qualified appraiser mutually agreeable to the Company and the estate of the deceased Member ... which shall equally bear equally [sic] the cost of such appraisal. The fair market value of the deceased Member's interest...shall be payable by the Company to the deceased Member's estate... within one hundred twenty (120) days of the establishment of such fair market value on the same payment terms as set forth in Section 9.4 of this Agreement.

The supreme court disagreed with the Bierman parties' argument that "fair market value" is a term of art necessitating reliance on factors outside of the agreements and agreed with Brenda's reading of the language of the operating agreements. The court found it unnecessary to rely on anything further to interpret the agreements' definition of "fair market value" because the plain language of the agreements stated that "the fair market value shall be determined by an independent and duly qualified appraiser mutually agreeable to the Company and the estate of the deceased Member."

The Bierman parties also complained of the trial court's finding that Galloway's appraisal was the fair market value of Rentals and Development, that Galloway was independent at the time of his appraisal, that Galloway used the appropriate date for his valuation, and that the appraisal was substantially completed as of November 30, 2015. The court found no clear error by the trial court with respect to any of these matters. The court stated that credibility of a witness is a question for the trier of fact and that the record showed that the parties agreed Galloway should conduct the appraisal pursuant to the operating agreement, that they agreed the appraisal date should be December 31, 2014, rather than date of Mark's death four months later, and that the appraisal was substantially completed as of November 30, 2015, thus starting the 120-day clock on the payment obligation under the operating agreement.

The Bierman parties next complained of the trial court's findings that they failed to negotiate in good faith, but the supreme court stated that the evidence supported Brenda's claim that, despite having agreed on the value of Rentals and Development, the Bierman parties rejected Galloway's valuation and failed to close on the purchase of Mark's interests in Rentals and Development only after the parties could not reach an agreement on the value of BD Construction, Inc. (the other entity in which Mark was a co-owner). The trial court heard conflicting testimony from Doug and Brenda regarding a meeting to negotiate values of Rentals and Development as well as BD Construction, Inc., and the record showed that the trial court found Brenda more credible.

The court also rejected the Bierman parties' argument that the trial court erred in not ordering specific performance of the contract for purchase of Mark's interests. A court cannot award specific performance to the breaching party unless the breach is minor or involves no substantial failure of the exchange, but the trial court specifically found that the breach was not minor and was a substantial failure of the exchange. Because the breach involved failure to close on the sale after the terms of the operating agreements regarding the sale were met, the supreme court concluded that the breach was not minor, but rather was a substantial failure of the exchange.

The final points of error asserted by the Bierman parties included the trial court's failure to adopt the values of the experts they provided at trial, the court's order to pay interest on the damages award, and the court's award of damages to Brenda. The supreme court found either no merit in these arguments or no clear error by the trial court.

*Matter of Estate of Cook*, 601 S.W.3d 453 (Ark. Ct. App. 2020).

The court of appeals reversed and remanded the trial court's order directing that a deceased member's ownership interest in a two-member Arkansas LLC pass to his estate rather than to the surviving member. The trial court found that the transfer-upon-death provision in the operating agreement failed due to lack of consideration, but the court of appeals held that the LLC's operating agreement unambiguously showed the members intended for a deceased member's ownership interest to transfer automatically to the surviving member and that the members supplied the necessary consideration for this automatic transfer through multiple mutual promises throughout the operating agreement.

In December 2014, Charles Cook and his grandson Jared Brooks formed Cook's Towing and Recovery, LLC, pursuant to a seven-page operating agreement filed with the Arkansas Secretary of State. Cook and Brooks, as the only members, each owned a 50% ownership interest in the LLC. A provision in the operating agreement provided that upon either member's death, incompetency, or bankruptcy, that member's ownership, interest, and income from the LLC would immediately transfer to the surviving member, without any buyout required. The operating agreement also stated that a member could sell or transfer his ownership interest with the consent of the other member but granted a right of first refusal. At the time of Cook's death in April 2017, the LLC's assets included vehicles used in the towing business as well as Cook's personal residence. Cook had three surviving children: Charlotte Smith (Brooks' mother), Crista Bowker, and Amy Willhite.

During a hearing in the probate proceedings, the trial court instructed the parties to submit briefs on Willhite's motion to determine that Cook's interest in the LLC did not pass automatically to Brooks but should be considered an asset of the estate. Brooks' trial brief asserted in part that the operating agreement was an independent, valid, and binding contract that clearly stated Cook's intent to have his ownership interest in the LLC transfer upon his death to Brooks as the surviving member. Smith filed a statement that she had no objection to the LLC being vested completely in Brooks. On the other hand, Willhite's brief attacked the validity of the LLC's creation. She argued that there was no valid business reason for Cook to transfer his personal residence to the LLC and claimed that there was no proof that Cook agreed to the language transferring his interest to Brooks because the operating agreement was missing dates, page numbers, initials of the signatories, and verification by a witness or notary. Willhite also claimed that the transfer provision in the operating agreement was an attempt to accomplish a testamentary disposition in an unverified and unwitnessed contract.

Concerning the ownership of the LLC interest, the trial court entered an order in which it directed that Cook's interest be considered an asset of his estate. The trial court found that, although the transfer of Cook's interest pursuant to the operating agreement was contractual in nature and not testamentary, the transfer provision lacked consideration and could not be effectuated. As a result, the court severed this provision from the remainder of the operating agreement in accordance with the severability clause in the agreement. The order further found that Brooks had a contractual right under the operating agreement to purchase Cook's interest from the estate as if Cook were selling his interest to a third party under the right of refusal clause. Brooks and Smith appealed.

Brooks and Smith contended that the trial court erred when it found that the operating agreement did not transfer Cook's ownership interest in the LLC to Brooks upon Cook's death. The court began its analysis by reviewing Arkansas case law for traditional principles of contractual



interpretation and construction. Next, the court noted that Arkansas LLCs are authorized by the Small Business Entity Pass Through Act (the “Arkansas Act”), which defines an “operating agreement” as the written agreement entered among all members as to an LLC’s business and affairs. The court pointed out that the Arkansas Act does not indicate any specific requirements or contents of the operating agreement itself but does provide that a person ceases to be a member of an LLC upon the person’s death unless otherwise provided in writing in an operating agreement. The court then observed that the LLC’s operating agreement specifically addressed what should happen if a member died, citing sections 8.4 and 8.7 as follows:

[8.4] On the death, adjudicated incompetence, or bankruptcy of a Member, the living member shall be the sole successor in interest to the deceased Member. Upon the death, incompetency, or bankruptcy of Jared Brooks, his ownership, interest, and income from the Company shall immediately transfer to Charles Cook. *Upon the death, incompetency, or bankruptcy of Charles Cook, his ownership, interest, and income from the Company shall immediately transfer to Jared Brooks.* In the event there is any legal contest to this automatic transfer of ownership, any other successors in interest to any deceased, incompetent, or insolvent Member (whether an estate, bankruptcy trustee, or otherwise) will receive only the economic right to receive distributions whenever made by the Company and the deceased, incompetent, or insolvent Member’s allocable share of taxable income, gain, loss, deduction, and credit (the “Economic Rights”).

[8.7] [U]pon the transfer of the interest in the Company by any deceased, incompetent, or insolvent Member, *there shall be no buy out required to accomplish the transfer upon death/incompetency/insolvency of either Charles Cook or Jared [Brooks].* All interest, shares, profits, and ownership shall automatically transfer to the remaining competent/solvent party.

(Emphasis added by the court.)

The court of appeals determined that the trial court properly recognized that this was a contractual transfer but erroneously found that the transfer failed due to lack of consideration. The court held that the language of sections 8.4 and 8.7 “clearly and unambiguously” established that Cook and Brooks intended for his ownership interest in the LLC to pass automatically and immediately to the surviving member in the event of either of their deaths. After stating the proposition that mutual promises made for the other constitute consideration, the court of appeals identified the following such promises between Cook and Brooks in the operating agreement: the two members contributed initial capital to the LLC; each agreed to operate and manage the company; and the transfer provisions applied to both of them and were structured so that they gave up rights for their respective estates and heirs to receive a buyout from the other. Thus, the court of appeals held that Cook and Brooks supplied the necessary consideration for the automatic transfer of ownership interest.

Willhite and Cook’s estate argued that the issue of adequate consideration should be analyzed at the time of death and asserted that the consideration given for the creation of the LLC should not be the same consideration to support the transfer that would occur only upon the death of Cook or Brooks. The court of appeals was not persuaded, reasoning that their position ignored contract-construction principles that require the terms of the contract be read as a whole. Because

Cook and Brooks created an LLC under the Arkansas Act and drafted an operating agreement to include terms clearly intending for the automatic transfer of a deceased member's interest to the surviving member, the court concluded that Cook's interest transferred to Brooks and not to Cook's estate. As a result, the court of appeals reversed and remanded the trial court's order determining that Cook's interest in the LLC was an asset of his estate.

***Homeland Energy Solutions, LLC v. Retterath***, 938 N.W.2d 664 (Iowa 2020).

In this dispute arising out of the refusal of an LLC member to sell his units back to the LLC pursuant to a member unit repurchase agreement executed by the member and the LLC, the Iowa Supreme Court held that: (1) the district court properly refused the member's demand for a jury trial because the LLC sought specific performance, which is a claim in equity; (2) neither the provisions of the LLC operating agreement nor Iowa law required member approval for the LLC to reacquire the member's units; (3) the member unit repurchase agreement was a binding contract despite the member's attempt to revoke his offer to sell his units; (4) the remedy of specific performance against the member was warranted; (5) the member's affirmative defenses were without merit; and (6) the indemnification provision in the member unit repurchase agreement did not support an award of attorney's fees against the breaching member because it did not clearly evidence the parties' intent to shift fees as opposed to protecting each party from claims brought by third parties.

In 2000, Steve Retterath invested several million dollars in three ethanol plants, one of which was Homeland Energy Solutions, LLC (HES). All three plants were formed as Iowa LLCs, and the interests were divided into units. Retterath purchased 25,860 HES units for approximately \$26 million during HES's initial offering of equity securities. His units gave him the right to appoint two members of HES's board of directors. Until June 2013, Retterath occupied one of those seats. Retterath was HES's largest unit holder, owning about 28% of the units.

In late 2012, Retterath began efforts to liquidate his investments in the three ethanol companies. He successfully negotiated and entered into member unit repurchase agreements with the other two companies and began discussions with HES about selling his HES units. A buyback committee was created to negotiate the repurchase of the units. By early 2013, Retterath and the buyback committee had not reached an agreement. Around this time, relations between Retterath, HES employees, and HES board members broke down. Retterath attempted to put friendly board members in place and even gave an HES director a check in the amount of \$100,000 to induce the director to vote with Retterath on board matters. HES began a bribery investigation into Retterath's conduct.

Negotiations continued into the summer of 2013 when Retterath and the HES board committee were finally able to come to an agreement on the terms of a membership unit repurchase agreement (MURA). The final MURA provided for HES to pay Retterath \$30 million in two installments, one at closing and the other by July 1, 2014. In June 2013, Retterath and HES executed the MURA. Four days after the execution, HES's board approved the MURA, but five days after the execution and one day after HES's board approval, Retterath attempted to revoke his offer to sell his units because he learned that the tax treatment of the payments would be ordinary income rather than capital gains. At no time did HES's members vote to approve the agreement.

Throughout the summer, Retterath continued to express his opinion that there was no agreement to sell because he had revoked his offer, but HES spent the rest of the summer preparing for an August 1, 2013 closing date. HES procured all of the necessary financing and lender approval necessary to repurchase the units. The scheduled closing did not happen on August 1, 2013. On August 14, 2013, HES filed a suit in equity seeking specific performance as the remedy. After HES filed suit, a long and complicated procedural battle took place during which two members allied with

Retterath were allowed to intervene in the case. After a bench trial, the district court found that there was a binding agreement, held that Retterath breached the agreement, rejected Retterath's affirmative defenses, and ordered Retterath's specific performance under the agreement.

The supreme court began by discussing two procedural issues, one of which was whether the district court erred in striking Retterath's jury demand. The court affirmed the district court's decision to strike Retterath's jury demand because HES's claim was one of equity. HES claimed Retterath breached the MURA by failing to perform and sought specific performance.

The supreme court next discussed whether member approval of the MURA was required by HES's operating agreement. Retterath (and the two other intervening members) argued that section 5.6 of the operating agreement required member approval of the MURA. Section 5.6 provided as follows:

(b) The Directors shall not have authority to, and they covenant and agree that they shall not cause the Company to, without the consent of a majority of the Membership Voting Interests:

....

(v) Cause the Company to acquire any equity or debt securities of any Director or any of its Affiliates, or otherwise make loans to any Director or any of its Affiliates.

HES, however, argued that the following language of section 5.16(vii) of the operating agreement granted the board of directors the sole authority with respect to reacquiring a member's units:

Board committees may exercise only those aspects of the Directors' authority which are expressly conferred by the Directors by express resolution. Notwithstanding the foregoing, however, a committee may not, under any circumstances: ... (vii) authorize or approve the reacquisition of Units, except according to a formula or method prescribed by the Directors ....

Considering section 5.6(b)(v) and section 5.16(vii) in conjunction, the court said it did not make sense that the directors could authorize the company to reacquire any member's or director's units without membership approval under section 5.16 but would need membership approval to acquire any of the directors' HES units—i.e., equity securities in HES—under section 5.6(b)(v). Thus, according to the court, “acquire” as used in section 5.6(b)(v) did not include a situation where HES “reacquires” its own units, and section 5.6(b)(v) thus did not require membership approval for the reacquisition of HES units.

Retterath attempted to argue that section 5.6(b)(v) was a specific provision whereas 5.16 was a general provision that did not limit 5.6(b)(v). He argued that section 5.6(b)(v) was specific because it was the only provision in the operating agreement that dictated how HES—through its directors—could acquire any equity security of a director and because section 5.6 was the only provision that specifically applied to the authority of the directors. In contrast, he characterized section 5.16 as just one of many provisions that applied to members generally.

The court rejected Retterath's argument for two reasons. First, the court said that other provisions of the operating agreement applied specifically to the authority of the directors—for example, provisions listing actions the directors were authorized to perform, allowing the directors to authorize one director to act as the agent of HES, and authorizing the directors to create committees. In addition, the court said that whether section 5.6(b)(v) was the only provision that

specifically applied to the authority of the directors did not shed light on whether the actual language used in section 5.6(b)(v) required membership approval before HES could acquire a director's equity securities. Second, section 5.6(b)(v) and section 5.16 were both specific and general in their own right. The court pointed out that section 5.6(b)(v) addressed the directors' authority to acquire any equity securities of a director—i.e., of a specific member—and section 5.16 addressed the authority of a committee created by the directors to reacquire any member's units—i.e., a specific type of equity security. Thus, under Retterath's reasoning, different portions of each provision would control different portions of the other provision, which the court said did not make sense.

Retterath next argued that section 4.1, and impliedly section 5.6(a)(ii), of the operating agreement required membership approval of the MURA. Section 4.1 authorized the directors to make distributions "to the Unit Holders in proportion to Units held," and section 5.6(a)(ii) prohibited the directors from "[k]nowingly engag[ing] in any act in contravention of this Agreement ..., except as otherwise provided in this Agreement" without unanimous consent of the members. Retterath argued that the two \$15 million payments to be made to him would be "liquidating distributions" and that such a distribution solely to him and not the other HES members in proportion to units held would violate section 4.1 and thus require unanimous member approval pursuant to section 5.6(a)(ii). But the court pointed out that section 4.1 specifically authorized the directors to "make distributions of Net Cash Flow." The term "net cash flow" was defined in the operating agreement to mean:

the gross cash proceeds of the Company less the portion thereof used to pay or establish reserves for Company expenses, debt payments, capital improvements, replacements and contingencies, all as reasonably determined by the Directors. "Net Cash Flow" shall not be reduced by Depreciation, amortization, cost recovery deductions or similar allowances, but shall be increased by any reductions of reserves previously established.

The court said that the funds HES was to use to pay Retterath for his units were not a distribution of HES's net cash flow. Furthermore, the court pointed to testimony of an attorney that "liquidating distribution" is a legal term used in the "tax code." The court stated that nothing in section 4.1 of the operating agreement or in any other provision of the agreement indicated that the term "distribution" was used in section 4.1 as a technical, legal term or that it included a specific, technical term used in tax law.

The court next considered whether public policy required membership approval of the MURA, either under Iowa common law or the Iowa Limited Liability Company Act. Retterath relied on section 489.407(3)(d)(3) of the Iowa LLC statute, which provides:

3. In a manager-managed limited liability company, all of the following rules apply:
  - ....
  - d. The consent of all members is required to do any of the following:
    - ....
    - (3) Undertake any other act outside the ordinary course of the company's activities.

Retterath argued that HES's actions regarding the MURA were outside the ordinary course of HES's activities. The court rejected this argument on the basis that Retterath waived the issue on appeal by failing to show what HES's ordinary course activities were or why the MURA related actions would have been outside HES's ordinary course actions. The court went on to state that, even if the issue was not waived, HES's operating agreement suggested actions related to a repurchase

agreement were not outside HES's ordinary course of activities. As an example, the court pointed to the following purpose clause in the operating agreement:

The nature of the business and purposes of the Company are to: ... (iii) engage in any other business and *investment activity* in which an Iowa limited liability company may lawfully be engaged, as determined by the Directors. The Company has the power to do any and all acts necessary, appropriate, proper, advisable, incidental or convenient to, and in furtherance of, the purposes of the Company ....

(Emphasis added by the court.) The court compared repurchasing a member's units in the LLC to engaging in transactions for interest in an LLC, which is an investment activity in which an Iowa LLC may engage. The court also pointed to section 5.4 of the operating agreement, which detailed ways in which HES directors were permitted to engage in transactions. The court identified various subsections of section 5.4 that: (1) listed actions the directors were authorized to perform, including conducting HES's business, carrying on HES's operations, and having and exercising the powers granted by the Iowa LLC statute to effect the purposes for which HES was organized; (2) authorized directors to "[a]cquire by purchase, lease or otherwise ... personal property which may be necessary, convenient, or incidental to the accomplishment of the purposes of the Company"; (3) allowed directors to execute agreements and contracts in connection with the management, maintenance, and operation of HES's business and affairs; (4) permitted directors to carry out contracts necessary to, incidental to, or connected with the purposes of HES as may be lawfully performed by an LLC under Iowa law; and (5) authorized taking or not taking actions not expressly prohibited or limited by the operating agreement or articles of organization to accomplish HES's purposes.

The intervening members also made an argument based on agency principles, the operating agreement, and section 489.110 of the Iowa LLC statute. Section 489.110 provides as follows:

The operating agreement may specify the method by which a specific act or transaction that would otherwise violate the duty of loyalty may be authorized or ratified by one or more disinterested and independent persons after full disclosure of all material facts.

The intervenors characterized the directors' action causing HES to acquire a director's equity securities in HES as insider- or self-dealing, and thus a breach of the duty of loyalty. Although the board ratified the chairman's execution of the MURA a few days after the chairman signed the MURA on behalf of HES, the intervenors argued that membership approval was required because only a principal can ratify the unauthorized act of an agent under Iowa law. The intervenors argued that section 5.6(b)(v)'s requirement of membership approval was the operating agreement's specified method of authorizing or ratifying the act that would otherwise violate the duty of loyalty. Thus, according to the intervenors, the principal was the membership rather than the board in this situation. The court rejected this argument based on its previous conclusion that the verb "acquire" in section 5.6(b)(v) did not include the verb "reacquire," and section 5.6(b)(v) thus did not apply to HES's "reacquisition" of a director's or affiliate's HES units. As a result, the court concluded that the board was not acting as an agent but rather as the principal.

The court next addressed whether the MURA was a valid and binding agreement. Retterath argued that the MURA was not binding because both parties had not signed the MURA by the June 13, 2013 deadline set forth in the MURA. The MURA contained the following provision:

**“THIS AGREEMENT SHALL NO LONGER BE A BINDING OFFER AND SHALL BE NULL AND VOID AND OF NO FURTHER EFFECT IF IT IS NOT FULLY SIGNED BY MEMBER AND DELIVERED TO THE COMPANY PRIOR TO 2:00 P.M. LOCAL TIME ON THURSDAY, JUNE 13, 2013.”** The court found no merit in Retterath’s argument because this provision expressly indicated the MURA deadline only applied to Retterath’s signature and delivery, and nothing in that section of the agreement conditioned the effectiveness or availability of the MURA on execution or approval of the agreement by HES or its board by June 13.

After concluding that the MURA was a binding agreement, the court analyzed at some length whether HES was entitled to the remedy of specific performance against Retterath. In sum, the court concluded that HES was entitled to specific performance based on the lack of an adequate remedy at law and HES’s good-faith performance of its obligations.

With respect to the lack of an adequate remedy at law, the court examined the following three factors: HES’s ability to procure a suitable substitute, the difficulty of proving damages, and the likelihood of collecting an award of damages. Because of the uniqueness of Retterath’s specific units, the court concluded that HES would be unable to “readily procure by the use of money a suitable substitute for the promised performance,” and that factor thus weighed in favor of HES’s contention that damages would not provide an adequate remedy for Retterath’s breach. With respect to the difficulty of proving damages, the court concluded that the loss caused by the inability to redeem Retterath’s units, to extinguish Retterath’s appointment powers, and to remove Retterath as a member of HES could not be estimated with reasonable certainty. Thus, this factor also supported HES’s contention that damages would not provide an adequate remedy. HES made no argument that it would not be able to collect a damages award from Retterath, and that factor thus weighed in favor of the adequacy of damages and against specific performance. Based on its consideration of all three factors, the court concluded that HES did not have an adequate remedy at law for Retterath’s breach of the MURA. The inadequacy of the remedy at law supported specific performance as a remedy.

The court then considered whether HES was precluded from obtaining specific performance by failing to act in good faith or failing to perform its obligations. The court reviewed the law and the evidence bearing on these issues and concluded that HES was excused from performance because Retterath repudiated the MURA. Furthermore, regardless of whether HES was excused by Retterath’s repudiation, the court concluded that the record revealed HES was ready, willing, and able to perform its obligations and it attempted to do so.

The court next held that the district court did not err in rejecting Retterath’s affirmative defenses of equitable estoppel, unilateral and mutual mistake, unclean hands, and substantive and procedural unconscionability. In connection with several of these defenses, Retterath argued that HES always intended, but did not disclose its intention, to allocate taxable income to him from the date of the scheduled closing through the scheduled second installment on July 1, 2014, without providing him any distributions to cover that tax liability. However, the court concluded that the record did not support Retterath’s claim that HES always intended to improperly allocate him taxable income and entered into the MURA with that intention. The evidence supported HES’s explanation that it did not develop that allocation plan until 2014. With respect to his mutual mistake argument, the court stated that “[o]n a spectrum, the resulting allocation of taxable income from the sale of Retterath’s units is more like an assumption related to something collateral to the contract than one of the parties’ foundational reasons for entering into the MURA.” Retterath made various other arguments to the effect that provisions of the MURA were extortionate, harsh, oppressive, or heavy-handed, but the court rejected all of Retterath’s arguments. The court could not say that HES used fraudulent or deceptive practices to procure Retterath’s assent, and the court emphasized that Retterath was a sophisticated party who was represented and advised by counsel.

The court next turned to the issue of whether the MURA supported an award of attorney's fees against Retterath. HES relied on the following indemnification provision of the MURA in support of its claim for recovery of attorney's fees:

Member agrees to indemnify, defend and hold harmless the Company and its members, managers, officers, directors, employees and representatives from and against any and all claims, suits, losses, liabilities, costs, damages, expenses, including reasonable attorneys' fees and costs, arising, directly or indirectly, out of or resulting from: (i) any breach or material inaccuracy of any representation or warranty by Member contained in this Agreement; or (ii) failure by Member to perform his obligation under this Agreement.

The court discussed case law in which it had held that indemnification clauses that use the terms "indemnify" and "hold harmless" evidence the parties' intent to protect a party from claims brought by third parties and cannot be used to shift attorney fees between the parties "unless the language of the clause shows an intent to clearly and unambiguously shift the fees." Based on this case law, the court held that the indemnification provision did not clearly and unambiguously express Retterath's and HES's intent to shift the attorney fees HES incurred in this breach of contract action. HES attempted to distinguish the MURA from the case law relied upon by the court on the ground that there were no plausible scenarios where a third-party would bring an action against HES if Retterath breached the MURA, but the court rejected that contention, pointing to examples in which Retterath's breach of the MURA could result in a third-party action against HES. Although the court agreed with Retterath on this point and reversed the district court's award of attorney's fees against him, the supreme court rejected Retterath's argument that he was entitled to sanctions against HES for having sought attorney's fees under the indemnification provision.

*Namerow v. PediatriCare Associates, LLC*, 218 A.3d 839 (N.J. Ch. Div. 2018).

A retired member brought an action against a New Jersey LLC and its three active members alleging various claims, including modification of the operating agreement by conduct, minority member oppression, and breach of fiduciary duties. The trial court granted summary judgment in favor of the LLC and its active members, holding that (1) the parties' course of conduct over a sixteen-year period did not modify the operating agreement; (2) the economic loss doctrine barred the retired member from recovering damages based on a claim of minority member oppression; and (3) there was nothing to suggest that the active members breached any fiduciary duty owed to the retired member.

In January 2000, four doctors, Namerow, Zucker, Bienstock, and Chism entered into an operating agreement to form PediatriCare Associates, LLC, a New Jersey limited liability company, for the purpose of owning and operating a medical practice. In March 2001, the parties entered into an Amended and Restated Operating Agreement (the "Agreement"). The Agreement provided members with the right to retire once they had reached the age of sixty and had provided twenty-five years of membership or service to the practice. Furthermore, the Agreement prescribed that the "retirement purchase price" of a retiring member's interest was calculated according to Section 10 of the Agreement (titled "Determination of Value") as follows:

The total value of the company ("company value") shall be the last dated amount set forth on the Certificate of Agreed Value, attached hereto as Exhibit G and made part hereto, executed by the members. The members shall exercise their best efforts to

meet not less than once per year for the purpose of considering a new value but their failure to meet or determine a value shall not invalidate the most recently executed Certificate of Agreed Value setting forth the company value then in effect. If the parties fail to agree on a revaluation as described above for more than two (2) years, the company value shall be equal to the last agreed upon value, adjusted to reflect the increase or decrease in the net worth of the company, including collectible accounts receivable, since the last agreed upon value. The value of a member's interest ("Value") shall mean the company value multiplied by the percentage interest held by said member and being purchased hereunder, less any indebtedness that the selling or disabled member, the Decedent, or a member departing for any other reason contemplated hereunder may have to the company or to the other members, whichever the case may be.

The most recent Certificate of Agreed Value attached to the Agreement, which stated that the "value of the company" was \$2.4 million, was dated January 1, 2000 and signed by Namerow, Zucker, Bienstock, and Chism.

Namerow announced his intention to retire in January 2016, which triggered the application of Section 10. Over the next several months, the parties obtained two appraisals, each using the fair market valuation methodology, for the purpose of reaching a settlement regarding the voluntary negotiated buyout number. No such number was ever reached and the Agreement was never amended.

Namerow filed this action on October 10, 2017 against Zucker, Bienstock, and Chism (collectively, the "Active Members") and the LLC, asserting claims for modification of the Agreement by conduct, oppression of a minority member, and breach of fiduciary duty. Both sides filed motions for partial summary judgment.

The first issue that the trial court addressed was whether the parties' course of conduct over a sixteen-year period modified the terms of the Agreement to require use of a fair market valuation, rather than a net worth valuation as required by Section 10, to value the practice. Namerow argued that the parties had modified the Agreement because they had ignored Section 10 on three prior occasions. The trial court was not persuaded and reasoned that there was no indication that the parties intended to informally modify Section 10 because one such occasion was wholly unrelated to the retirement buyout purchase price of a member and, based on this litigation, the other two occasions did not settle the disagreement. The court then noted that the Agreement stated that it can only be modified by a vote of 80% of the membership interests and there was no evidence that Namerow or the Active Members agreed to formally modify Section 10. Therefore, the trial court granted summary judgment in favor of the LLC and the Active Members on Namerow's claim that the parties' conduct modified Section 10 to require the use of a fair market valuation methodology to determine his retirement purchase price.

Next, the trial court addressed Namerow's claim of minority member oppression under the New Jersey Revised Uniform Limited Liability Company Act (the "New Jersey LLC Act"). Under the New Jersey LLC Act, judicial recourse is available to minority members who have been "oppressed" by the majority members. New Jersey case law defines "oppression" as "frustrating a [member's] reasonable expectations" and "is usually directed at a minority [member] personally[.]" Thus, a minority member has a genuine claim for oppression under the New Jersey LLC Act when their reasonable expectations have been frustrated by the majority members. According to Namerow, he had a reasonable expectation that his 25% membership interest would be purchased using a fair market valuation methodology. In further support of his oppression claim, Namerow referenced an



earlier ruling from the court in which it denied the defendants' motion to dismiss because, at that time, his expectation was reasonable. The trial court pointed out that its earlier ruling was made at a preliminary stage in the litigation and, after discovery and the court's determination that the net worth methodology applied, it was clear that the defendants' conduct did not support a claim for oppression under the New Jersey LLC Act. Furthermore, the court cited New Jersey case law for the proposition that the economic loss doctrine prohibits plaintiffs from recovering in tort economic losses to which their entitlement only flows from a contract. Because this claim was contractual in nature and Namerow's entitlement flowed from the Agreement, the trial court held that his minority member oppression claim failed as a matter of law because it was barred by the economic loss doctrine.

The third issue that the trial court addressed was whether the defendants breached the fiduciary duties owed to Namerow. Under the New Jersey LLC Act, each member of a member-managed LLC owes the company and the other members a duty of care. The court observed that Namerow's claim for breach of fiduciary duty was based on many of the same recycled allegations from his other claims and were unconvincing for the same reasons. The trial court further reasoned that there was no valid claim for breach of fiduciary duty based on the members of a member-managed LLC acting in conformity with the Agreement. Thus, the trial court granted summary judgment in favor of the LLC and the Active Members on Namerow's claim for breach of fiduciary duty.

### **Rights of Transferee of Membership Interest or Partnership Interest**

*Benjamin v. Bierman*, 943 N.W.2d 283 (Neb. 2020).

In an action by a deceased member's personal representative seeking judicially ordered dissolution of two LLCs and asserting breach of contract by the surviving members based on their failure to buy out the deceased member's interests, the Nebraska Supreme Court held that the personal representative lacked standing to seek dissolution of LLCs because she was not a member. With respect to the breach-of-contract claim, the court held that the operating agreements' repurchase provisions required a determination of fair market value of the deceased member's interest by agreement of the parties or, absent agreement, by an independent appraiser, and the trial court did not clearly err in its findings regarding the actions taken in connection with the appraisal and buyout process, including its finding that the surviving members failed to negotiate in good faith and breached operating agreements.

Mark Benjamin owned a one-half interest in Sixth Street Rentals, LLC ("Rentals") along with Doug Bierman and a one-third interest in Sixth Street Development, LLC ("Development") along with Doug Bierman and Doug's father, Eugene Bierman. Mark passed away on April 14, 2015, leaving his wife Brenda Benjamin as his primary beneficiary and the personal representative of his estate. Prior to his death, Mark was acting manager of both LLCs. After Mark's death, Doug took over the manager position for both LLCs.

Counsel for both Rentals and Development sent notices to Brenda pursuant to the respective separate but identical operating agreements, stating the LLCs' intention to buy Mark's interests. Brenda testified at trial that she and Doug had generally reached an agreement pursuant to which Doug would buy out Mark's interest in Rentals, and Doug and Eugene would buy out Mark's interest in Development. Brenda would receive Development's interest in a store facility jointly owned by Development, a third party, and Mark's estate as an offset for the purchase price for Mark's interest in Development.

The parties agreed to close on the buyouts of Mark’s interests in Rentals and Development as well as a corporation in which Mark owned shares on April 15, 2016. The parties had valuations done on Rentals and Development by Terry Galloway. The parties did not close on the specified date, and Brenda sued the Biermans and the LLCs on June 1, 2016. After a bench trial, the trial court found that the Biermans, Rentals, and Development had breached the operating agreements of Rentals and Development, ordered an accounting for each company, declined to dissolve either, and awarded Brenda damages.

Brenda appealed the trial court’s decision not to order dissolution of both Rentals and Development. The Biermans, Rentals, and Development (collectively, the “Bierman parties”) cross-appealed alleging numerous points of error. The court grouped the Bierman parties’ points of error into the following categories: assignments of error related to fair market value, assignments of error related to breach of contract and specific performance, and remaining assignments of error.

The court first dealt with Brenda’s appeal. Brenda based her argument on Neb. Rev. Stat. 21-147(a), which states in part:

A limited liability company is dissolved, and its activities must be wound up, upon the occurrence of any of the following:

...

(4) on application by a member, the entry by the district court of an order dissolving the company on grounds that:

...

(B) it is not reasonably practicable to carry on the company’s activities in conformity with the certificate of organization and the operating agreement; or

(5) on application by a member, the entry by the district court of an order dissolving the company on the grounds that the managers or those members in control of the company:

...

(B) have acted or are acting in a manner that is oppressive and was, is, or will be directly harmful to the applicant.

The court did not address the merits of the claims under these two subsections. Instead it focused on the fact that Brenda lacked standing to request dissolution since she was not a member of either LLC.

The Nebraska Uniform Limited Liability Company Act defines a member as “a person that has become a member of a limited liability company under section 21-130 and has not dissociated under section 21-145.” Section 21-145 provides that a person is “dissociated as a member from a limited liability company” upon the death of that person. The court held that Mark ceased to be a member of each LLC upon his death and explained that a member’s right to participate as a member in the management and conduct of the company’s activities terminates upon dissociation of the member. The deceased member’s personal representative may only exercise the rights of a transferee provided in the statute and, for purposes of settling the estate, certain rights (primarily the right to have access to records or other information concerning the company’s activities) of a current member. Since Brenda was not a member, she did not have the right to seek dissolution under the statute.

The court also rejected Brenda’s argument that the operating agreement granted Mark the power to transfer governance power, along with his economic interest, in Rentals and Development. The provision relied upon by Brenda provided:

Any Member may transfer by gift or bequest all or any portion of his or her interest in the Company to a spouse or child of the transferring Member, or to a trust established for the benefit of such spouse or child, or to an existing Member of the Company upon written notice to the Company, of such gift or bequest.

The court interpreted the plain language of this section as permitting the transfer of some or all of a member's or dissociated member's interest in an LLC by gift or bequest, noting that the Nebraska LLC statute provides that an interest in an LLC is personal property that is transferable. But the court pointed out that the transfer of an interest is accompanied by limited rights, as previously discussed by the court, and the court did not read the language of the operating agreements as broadening the rights accompanying the interest to include governance power or any other power beyond that provided by the statute.

The court then turned to the numerous points of error brought by the Bierman parties on cross-appeal. The primary arguments centered around the fair market value of Rentals and Development. The Bierman parties argued that the operating agreement did not set forth an unambiguous method for determining the fair market value of Rentals and Development. Brenda argued that the operating agreements were clear in setting out fair market value determinations by either allowing the parties to agree to fair market value or, absent agreement, to appoint an independent third-party appraiser, and the court agreed with Brenda. The court also found no clear error by the trial court with respect to its findings regarding the independence of the appraiser and the actions taken in connection with the appraisal and buyout process, including its finding that the surviving members failed to negotiate in good faith and breached operating agreements.

***Estate of Streightoff v. Commissioner of Internal Revenue***, 954 F.3d 713 (5th Cir. 2020).

The court affirmed the tax court's ruling that an estate held a substituted limited partnership interest, and not an unadmitted assignee interest, in a Texas limited partnership.

In 2008, Frank Streightoff formed Streightoff Investments, LP ("SILP"), a Texas limited partnership [although identified by the court as a "limited liability partnership"], and established the Frank D. Streightoff Revocable Living Trust (the "Revocable Trust") for estate-planning purposes. Frank later died testate in 2011. SILP was funded using Frank's assets and its ownership was structured as follows: Streightoff Management, LLC ("LLC GP") held a 1% limited partnership interest as SILP's sole general partner, Frank held an 88.99% limited partnership interest, his daughters each held a 1.54% limited partnership interest, and his sons and former daughter-in-law each held a 0.77% limited partnership interest. Elizabeth Streightoff, one of Frank's daughters, was the trustee of the Revocable Trust, the managing member of LLC GP, his power of attorney, and the executor of his estate (the "Estate"). On the same day that he created SILP and the Revocable Trust, Frank assigned his 88.99% interest in SILP to the Revocable Trust. Elizabeth executed the Assignment of Interest to the Revocable Trust (the "Assignment") as Frank's power of attorney. She also signed (1) the approval of the transfer as LLC GP's managing member, SILP's general partner; and (2) for the assignee, as trustee for the Revocable Trust. The Assignment stated, "Assignor's interest ... together with all and singular the rights and appurtenances thereto in anywise belonging, unto the said Assignee, its beneficiaries and assigns forever."

The Estate filed its tax return in May 2012 with a taxable estate that included the SILP interest as an assignee interest with a purported valuation that claimed discounts for lack of marketability, lack of control, and lack of liquidity. The Commissioner of Internal Revenue (the "Commissioner") issued a Notice of Deficiency (the "Notice") to the Estate in January 2015. Attached to the Notice was a form in which the Commissioner stated that the fair market value of

the Estate's 88.99% interest was corrected and increased because the net asset value should only be discounted for a lack of marketability. The Estate petitioned the tax court for a redetermination of the estate tax deficiency. Following a bench trial, the tax court sustained the Commissioner's determinations and ruled, in part, that the Estate held a substituted limited partnership interest in SILP. According to the tax court, the Assignment validly assigned to the Revocable Trust the 88.99% interest as a limited partnership interest both in substance and form. Therefore, the Estate, as the beneficiary of the Revocable Trust, included a limited partnership interest in SILP. The Estate appealed.

With respect to the characterization of the assigned interest in SILP, the Estate contended that the tax court's substance-over-form rationale stood contrary to Texas partnership law. The court of appeals began its analysis by stating that a tax court relies on state law to discern the types of assets held within an estate. Because the SILP partnership agreement (the "SILP Agreement") provided that Texas was the governing jurisdiction, the court would look to § 153.251(b) of the limited partnership statute if the SILP Agreement was silent. Tex. Bus. Orgs. Code § 153.251(b) (outlining provisions for partnership assignments that apply *unless* "otherwise provided by the partnership agreement") (emphasis supplied by the court). By its terms, the Assignment was governed by the SILP Agreement. Therefore, the court would look only to the SILP Agreement because it was not silent as to the nature of the interest transferred under the Assignment. The court then focused on the following two provisions of the SILP Agreement:

9.2 Permitted Transfers.... [A]n Interest Holder may at any time [t]ransfer his Interests to (a) any member of transferor's Family, (b) the transferor's executor, administrator, trustee or personal representative to whom such interests are transferred at death or involuntarily by operation of law, or (c) [to any purchaser, but subject to the right of first refusal held by the persons listed in section 9.4]

...

9.7 Admissions of Interest Holders as Partners. A transferee of an Interest may be admitted to the Partnership as a Substituted Limited Partner only upon satisfaction of the conditions set forth below:

(a) Each General Partner consents to such admission which consent may be granted or withheld in the sole and absolute discretion of each General Partner;

(b) The Interests with respect to which the transferee is being admitted were acquired by means of a Permitted Transfer ....

The Estate argued that the Assignment conveyed only an unadmitted assignee interest to the Revocable Trust as a matter of form because (1) LLC GP did not consent to the admission of a transferee or assignee as a Substituted Limited Partner under Section 9.7(a); and (2) the Assignment's written approval was limited to effectuate the transfer under Section 7.2, which required written approval for an assignment of interest. The Commissioner argued, and the court agreed, that the Assignment's broad language transferred Frank's full partnership rights to the Revocable Trust and Elizabeth consented to that transfer as a substituted limited partnership interest when she signed and approved the Assignment.

The court of appeals concluded that LLC GP consented to the transfer of a substituted limited partnership interest to the Revocable Trust when Elizabeth signed the Assignment. First, the court stated that Section 9.7(b) was satisfied because the parties had stipulated that the Assignment was a Permitted Transfer under Section 9.2. Second, the court reasoned that Section 9.7(a) was satisfied when Elizabeth, as managing member of LLC GP, SILP's general partner, signed the Assignment under the "Approved By" legend. The court observed that, while the SILP Agreement used consent and approval interchangeably, the words were only distinguished with the qualifier "written." Because this qualifying language was absent in Section 9.7(a), Elizabeth had unilateral discretion to admit the assigned interest as a Substituted Limited Partner. The court explained that, when Elizabeth gave written approval with her signature, it was binding on SILP and represented SILP's recognition that the Assignment conveyed "all and singular ... [SILP] rights and appurtenances" of Frank, which encompassed his 88.99% limited partnership interest. Third, the court determined that this stipulated Section 9.2 Permitted Transfer did not need to adhere to Section 7.2 and, in any event, Elizabeth's signature could satisfy both Section 7.2 and Section 9.7 because Section 9.7(a) did not specify the type of approval necessary. The court further reasoned that her signature made no attempt to either disclaim the portion of the Assignment purporting to convey the entirety of Frank's limited partnership interest or otherwise confine the written approval to any particular section of the SILP Agreement. Fourth, the court noted that the unambiguous language of the Assignment purported to convey more than an assignee interest, which was limited to allocations and distributions under the SILP Agreement. The court commented that, notwithstanding the document's label, it was "difficult to reconcile the Estate's characterization of the Assignment given [its] language."

Next, the court of appeals concluded that the Assignment was the functional equivalent of transferring a limited partnership interest because the transfer lacked economic substance outside of tax avoidance. The court referenced case law for the proposition that the substance-over-form doctrine permits it to determine the characterization of a transaction based on the underlying substance and not the legal form. After acknowledging that SILP limited partners appeared to have managerial power that unadmitted assignees did not, the court noted that there were no practical differences after executing the Assignment and observed that no limited partners other than Elizabeth exercised their partnership rights and responsibilities. The court further reasoned that, even if it were to assume that the Assignment transferred to the Revocable Trust an unadmitted assignee interest as a matter of form, there was no substantial difference before and after the transfer.

In sum, the court of appeals held that the Assignment transferred to the Revocable Trust the 88.99% interest as a substituted limited partnership interest as opposed to an unadmitted assignee interest, stating that this interpretation complied with the SILP Agreement and did not offend Texas partnership law. Thus, the court of appeals affirmed the tax court's ruling that the Estate, in turn, held a substituted limited partnership interest in SILP.

***Behrend v. New Windsor Group, LLC***, 180 A.D.3d 636 (N.Y. App. Div. 2d 2020).

The appellate court affirmed the trial court's order that denied a putative assignee's motion for summary judgment in the assignee's action seeking a declaratory judgment that he held a membership interest in a New York LLC and an interest in the LLC's assets. The court held that the alleged assignment of the membership interest in the LLC was ineffective to make the assignee a member and that the effect of such an assignment was limited to entitling the assignee to receive the distributions and allocations of profits and losses to which the assignor would have been entitled prior to the assignor's resignation as member.

In April 2012, Julius Behrend sued New Windsor Group, LLC ("NWG"), Andrew Perkal as NWG's managing member, and Joseph Klein, seeking in part a declaratory judgment that he had a

50% membership interest in NWG and a 50% interest in certain NWG assets. Behrend's complaint included allegations that he had loaned to Klein more than \$2.5 million over the course of ten years and that, in December 2007, they entered into an agreement in which Klein agreed to assign his interest in NWG to Behrend. The complaint further alleged that NWG and Perkal (collectively, the "NWG Defendants") had refused to honor Behrend's membership interest in NWG or his interest in its assets. Klein did not appear in the case, but the NWG Defendants generally denied the allegations in their answer and asserted that whatever interest Klein may have had in NWG was transferred and extinguished prior to Behrend's suit. Behrend moved for summary judgment and included a "memorandum of understanding" between "Gmach Beth Joel-Julius Behrend" and Klein that was dated December 31, 2007, contained Klein's acknowledgment that he owed Behrend a certain amount of money, and documented their agreement for Klein to transfer his interest in NWG to Behrend.

In their cross-motion for summary judgment, the NWG Defendants submitted a copy of NWG's operating agreement that identified Perkal and his wife as the only members of NWG. Perkal stated in an affirmation that the NWG operating agreement was never amended and no new members were ever added. Perkal also stated that, prior to this action, Behrend did not contact him or claim that Klein had transferred his interest to him. Perkal explained that he had entered into an agreement with Klein to develop a shopping center owned by NWG and, under the terms of this agreement, Klein could eventually become a member. Klein, however, defaulted on that agreement, which resulted in arbitration, and he never became a member of NWG. The NWG Defendants also submitted evidence that, pursuant to an order of the same trial court confirming the arbitration award, Klein transferred any interest he had in NWG to Perkal and resigned as a member on April 26, 2012.

The trial court denied Behrend's motion for summary judgment, granted the NWG Defendants' cross-motion, declared that Behrend did not have a 50% membership interest in NWG or a 50% interest in any of its assets, and dismissed the remainder of the complaint. The trial court found that Behrend failed to establish that Klein transferred his interest in NWG to Behrend and that, at most, Klein had transferred only a security interest that was never perfected. Furthermore, the trial court determined that Behrend could have no interest in NWG's assets because a member does not have an interest in specific property of the LLC under the New York LLC statute. The court also found that it did not need to make a determination as to any membership interest Klein previously held in NWG because the evidence established that no assignment occurred in accordance with NWG's operating agreement and Klein had transferred whatever interest in NWG he had to Perkal in April 2012. Behrend appealed.

The appellate court began its analysis by reviewing the statutory provisions addressing the assignment of a membership interest and observed that an interest is assignable in whole or in part but such an assignment "does not . . . entitle the assignee to participate in the management and affairs of the [LLC] or to become or to exercise any rights or powers of a member." N.Y. Ltd. Liab. Co. § 603(a)(1), (2). The court pointed out that the New York LLC statute provides "the only effect of an assignment of a membership interest is to entitle the assignee to receive, to the extent assigned, the distributions and allocations of profits and losses to which the assignor would be entitled." N.Y. Ltd. Liab. Co. § 603(a)(3). The appellate court, however, also pointed out that a person can become a member of an LLC by assignment, but only where the operating agreement provides that the assignor-member has the power to grant the assignee the right to become a member and there is compliance with any conditions of that power. N.Y. Ltd. Liab. Co. § 602(b)(2).

Next, the court stated that the NWG operating agreement allowed a member to transfer the member's membership interest, but "only with the prior unanimous consent of the other Members either in writing or at a meeting called for such purpose." The court noted that the NWG Defendants

supported their cross motion by submitting evidence that there had not been any prior unanimous consent allowing for the transfer of any membership interest to Behrend, and the court concluded that Behrend failed to raise a triable issue of fact on this issue. Thus, the court held that Klein's alleged assignment of his membership interest in NWG to Behrend was ineffective to make Behrend a member. The court stated that the NWG Defendants had established that any interest Klein may have had in NWG was extinguished as of April 26, 2012, when he transferred that interest to Perkal and resigned as a member. As a result, the court held that, to the extent that Klein purportedly transferred his membership interest to Behrend, the effect of the assignment was limited to entitling Behrend to the distributions and allocations of profits and losses that Klein would have received from December 31, 2007, to April 26, 2012. Therefore, the appellate court agreed with the trial court's order and affirmed.

### **Dissociation or Withdrawal of Member**

*Benjamin v. Bierman*, 943 N.W.2d 283 (Neb. 2020).

In an action by a deceased member's personal representative seeking judicially ordered dissolution of two LLCs and asserting breach of contract by the surviving members based on their failure to buy out the deceased member's interests, the Nebraska Supreme Court held that the personal representative lacked standing to seek dissolution of LLCs because she was not a member. With respect to the breach-of-contract claim, the court held that the operating agreements' repurchase provisions required a determination of fair market value of the deceased member's interest by agreement of the parties or, absent agreement, by an independent appraiser, and the trial court did not clearly err in its findings regarding the actions taken in connection with the appraisal and buyout process, including its finding that the surviving members failed to negotiate in good faith and breached the operating agreements.

Mark Benjamin owned a one-half interest in Sixth Street Rentals, LLC ("Rentals") along with Doug Bierman and a one-third interest in Sixth Street Development, LLC ("Development") along with Doug Bierman and Doug's father, Eugene Bierman. Mark passed away on April 14, 2015, leaving his wife Brenda Benjamin as his primary beneficiary and the personal representative of his estate. Prior to his death, Mark was acting manager of both LLCs. After Mark's death, Doug took over the manager position for both LLCs.

Counsel for both Rentals and Development sent notices to Brenda pursuant to the respective separate but identical operating agreements, stating the LLCs' intention to buy Mark's interests. Brenda testified at trial that she and Doug had generally reached an agreement pursuant to which Doug would buy out Mark's interest in Rentals, and Doug and Eugene would buy out Mark's interest in Development. Brenda would receive Development's interest in a store facility jointly owned by Development, a third party, and Mark's estate as an offset for the purchase price for Mark's interest in Development.

The parties agreed to close on the buyouts of Mark's interests in Rentals and Development as well as a corporation in which Mark owned shares on April 15, 2016. The parties had valuations done on Rentals and Development by Terry Galloway. The parties did not close on the specified date, and Brenda sued the Biermans and the LLCs on June 1, 2016. After a bench trial, the trial court found that the Biermans, Rentals, and Development had breached the operating agreements of Rentals and Development, ordered an accounting for each company, declined to dissolve either, and awarded Brenda damages.

Brenda appealed the trial court's decision not to order dissolution of both Rentals and Development. The Biermans, Rentals, and Development (collectively, the "Bierman parties")

cross-appealed alleging numerous points of error. The court grouped the Bierman parties' points of error into the following categories: assignments of error related to fair market value, assignments of error related to breach of contract and specific performance, and remaining assignments of error.

The court first dealt with Brenda's appeal. Brenda based her argument on Neb. Rev. Stat. 21-147(a), which states in part:

A limited liability company is dissolved, and its activities must be wound up, upon the occurrence of any of the following:

...

(4) on application by a member, the entry by the district court of an order dissolving the company on grounds that:

...

(B) it is not reasonably practicable to carry on the company's activities in conformity with the certificate of organization and the operating agreement; or

(5) on application by a member, the entry by the district court of an order dissolving the company on the grounds that the managers or those members in control of the company:

...

(B) have acted or are acting in a manner that is oppressive and was, is, or will be directly harmful to the applicant.

The court did not address the merits of the claims under these two subsections. Instead it focused on the fact that Brenda lacked standing to request dissolution since she was not a member of either LLC.

The Nebraska Uniform Limited Liability Company Act defines a member as "a person that has become a member of a limited liability company under section 21-130 and has not dissociated under section 21-145." Section 21-145 provides that a person is "dissociated as a member from a limited liability company" upon the death of that person. The court held that Mark ceased to be a member of each LLC upon his death and explained that a member's right to participate as a member in the management and conduct of the company's activities terminates upon dissociation of the member. The deceased member's personal representative may only exercise the rights of a transferee provided in the statute and, for purposes of settling the estate, certain rights (primarily the right to have access to records or other information concerning the company's activities) of a current member. Since Brenda was not a member, she did not have the right to seek dissolution under the statute.

The court also rejected Brenda's argument that the operating agreement granted Mark the power to transfer governance power, along with his economic interest, in Rentals and Development. The provision relied upon by Brenda provided:

Any Member may transfer by gift or bequest all or any portion of his or her interest in the Company to a spouse or child of the transferring Member, or to a trust established for the benefit of such spouse or child, or to an existing Member of the Company upon written notice to the Company, of such gift or bequest.

The court interpreted the plain language of this section as permitting the transfer of some or all of a member's or dissociated member's interest in an LLC by gift or bequest, noting that the Nebraska LLC statute provides that an interest in an LLC is personal property that is transferable. But the court pointed out that the transfer of an interest is accompanied by limited rights, as previously discussed



by the court, and the court did not read the language of the operating agreements as broadening the rights accompanying the interest to include governance power or any other power beyond that provided by the statute.

The court then turned to the numerous points of error brought by the Bierman parties on cross-appeal. The primary arguments centered around the fair market value of Rentals and Development. The Bierman parties argued that the operating agreement did not set forth an unambiguous method for determining the fair market value of Rentals and Development. Brenda argued that the operating agreements were clear in setting out fair market value determinations by either allowing the parties to agree to fair market value or, absent agreement, to appoint an independent third-party appraiser, and the court agreed with Brenda. The court also found no clear error by the trial court with respect to its findings regarding the independence of the appraiser and the actions taken in connection with the appraisal and buyout process, including its finding that the surviving members failed to negotiate in good faith and breached operating agreements.

*Matter of Estate of Cook*, 601 S.W.3d 453 (Ark. Ct. App. 2020).

The court of appeals reversed and remanded the trial court's order directing that a deceased member's ownership interest in a two-member Arkansas LLC pass to his estate rather than to the surviving member. The trial court found that the transfer-upon-death provision in the operating agreement failed due to lack of consideration, but the court of appeals held that the LLC's operating agreement unambiguously showed the members intended for a deceased member's ownership interest to transfer automatically to the surviving member and that the members supplied the necessary consideration for this automatic transfer through multiple mutual promises throughout the operating agreement.

In December 2014, Charles Cook and his grandson Jared Brooks formed Cook's Towing and Recovery, LLC, pursuant to a seven-page operating agreement filed with the Arkansas Secretary of State. Cook and Brooks, as the only members, each owned a 50% ownership interest in the LLC. A provision in the operating agreement provided that upon either member's death, incompetency, or bankruptcy, that member's ownership, interest, and income from the LLC would immediately transfer to the surviving member, without any buyout required. The operating agreement also stated that a member could sell or transfer his ownership interest with the consent of the other member but granted a right of first refusal. At the time of Cook's death in April 2017, the LLC's assets included vehicles used in the towing business as well as Cook's personal residence. Cook had three surviving children: Charlotte Smith (Brooks' mother), Crista Bowker, and Amy Willhite.

During a hearing in the probate proceedings, the trial court instructed the parties to submit briefs on Willhite's motion to determine that Cook's interest in the LLC did not pass automatically to Brooks but should be considered an asset of the estate. Brooks' trial brief asserted in part that the operating agreement was an independent, valid, and binding contract that clearly stated Cook's intent to have his ownership interest in the LLC transfer upon his death to Brooks as the surviving member. Smith filed a statement that she had no objection to the LLC being vested completely in Brooks. On the other hand, Willhite's brief attacked the validity of the LLC's creation. She argued that there was no valid business reason for Cook to transfer his personal residence to the LLC and claimed that there was no proof that Cook agreed to the language transferring his interest to Brooks because the operating agreement was missing dates, page numbers, initials of the signatories, and verification by a witness or notary. Willhite also claimed that the transfer provision in the operating agreement was an attempt to accomplish a testamentary disposition in an unverified and unwitnessed contract.

Concerning the ownership of the LLC interest, the trial court entered an order in which it directed that Cook's interest be considered an asset of his estate. The trial court found that, although

the transfer of Cook's interest pursuant to the operating agreement was contractual in nature and not testamentary, the transfer provision lacked consideration and could not be effectuated. As a result, the court severed this provision from the remainder of the operating agreement in accordance with the severability clause in the agreement. The order further found that Brooks had a contractual right under the operating agreement to purchase Cook's interest from the estate as if Cook were selling his interest to a third party under the right of refusal clause. Brooks and Smith appealed.

Brooks and Smith contended that the trial court erred when it found that the operating agreement did not transfer Cook's ownership interest in the LLC to Brooks upon Cook's death. The court began its analysis by reviewing Arkansas case law for traditional principles of contractual interpretation and construction. Next, the court noted that Arkansas LLCs are authorized by the Small Business Entity Pass Through Act (the "Arkansas Act"), which defines an "operating agreement" as the written agreement entered among all members as to an LLC's business and affairs. The court pointed out that the Arkansas Act does not indicate any specific requirements or contents of the operating agreement itself but does provide that a person ceases to be a member of an LLC upon the person's death unless otherwise provided in writing in an operating agreement. The court then observed that the LLC's operating agreement specifically addressed what should happen if a member died, citing sections 8.4 and 8.7 as follows:

[8.4] On the death, adjudicated incompetence, or bankruptcy of a Member, the living member shall be the sole successor in interest to the deceased Member. Upon the death, incompetency, or bankruptcy of Jared Brooks, his ownership, interest, and income from the Company shall immediately transfer to Charles Cook. *Upon the death, incompetency, or bankruptcy of Charles Cook, his ownership, interest, and income from the Company shall immediately transfer to Jared Brooks.* In the event there is any legal contest to this automatic transfer of ownership, any other successors in interest to any deceased, incompetent, or insolvent Member (whether an estate, bankruptcy trustee, or otherwise) will receive only the economic right to receive distributions whenever made by the Company and the deceased, incompetent, or insolvent Member's allocable share of taxable income, gain, loss, deduction, and credit (the "Economic Rights").

[8.7] [U]pon the transfer of the interest in the Company by any deceased, incompetent, or insolvent Member, *there shall be no buy out required to accomplish the transfer upon death/incompetency/insolvency of either Charles Cook or Jared [Brooks].* All interest, shares, profits, and ownership shall automatically transfer to the remaining competent/solvent party.

(Emphasis added by the court.)

The court of appeals determined that the trial court properly recognized that this was a contractual transfer but erroneously found that the transfer failed due to lack of consideration. The court held that the language of sections 8.4 and 8.7 "clearly and unambiguously" established that Cook and Brooks intended for his ownership interest in the LLC to pass automatically and immediately to the surviving member in the event of either of their deaths. After stating the proposition that mutual promises made for the other constitute consideration, the court of appeals identified the following such promises between Cook and Brooks in the operating agreement: the two members contributed initial capital to the LLC; each agreed to operate and manage the company;

and the transfer provisions applied to both of them and were structured so that they gave up rights for their respective estates and heirs to receive a buyout from the other. Thus, the court of appeals held that Cook and Brooks supplied the necessary consideration for the automatic transfer of ownership interest.

Willhite and Cook's estate argued that the issue of adequate consideration should be analyzed at the time of death and asserted that the consideration given for the creation of the LLC should not be the same consideration to support the transfer that would occur only upon the death of Cook or Brooks. The court of appeals was not persuaded, reasoning that their position ignored contract-construction principles that require the terms of the contract be read as a whole. Because Cook and Brooks created an LLC under the Arkansas Act and drafted an operating agreement to include terms clearly intending for the automatic transfer of a deceased member's interest to the surviving member, the court concluded that Cook's interest transferred to Brooks and not to Cook's estate. As a result, the court of appeals reversed and remanded the trial court's order determining that Cook's interest in the LLC was an asset of his estate.

### **Judicial Dissolution**

*Manere v. Collins*, 241 A.3d 133 (Conn. App. 2020).

The court held that, under Connecticut law, the crucial factor to consider when deciding if the majority has engaged in oppressive conduct justifying court-ordered dissolution is the minority member's reasonable expectations.

Manere and Collins were high school classmates who both worked in the bar and restaurant industry after graduation. After reconnecting at their thirty-year high school reunion, Manere and Collins formed BAHR, LLC (BAHR) in 2011 to purchase and operate a café in the Fairfield area that was popular with local college students. They organized BAHR as a manager-managed LLC with both men named as the managers. Both provided initial capital contributions and priority member loans to fund the business's startup. Specifically, Collins provided a \$600 capital contribution and a \$149,400 loan, while Manere provided a \$400 capital contribution and a \$19,600 loan. Collins held a 60% membership interest, and Manere held 40%. At the time, Collins owned and operated a successful bar in New York City and intended to remain in New York; therefore, Manere and Collins agreed that Manere would manage the café's day-to-day operations. The two men agreed to pay Manere a \$600 per week salary. Shortly thereafter, Collins agreed to raise Manere's managerial salary to \$1,000 per week. Unbeknownst to Collins, Manere also used BAHR's funds to pay for his personal expenses, including his health insurance, car payments, and gas.

In 2012, Hurricane Sandy severely damaged the café, and Collins and Manere agreed not to take any guaranteed payments from BAHR for one year while they worked to get the café back on its feet. Manere, however, did not adhere to this agreement, and he used BAHR cash to pay personal expenses, continued drawing a salary, and even unilaterally raised his salary to \$1,500 per week.

In 2015, Collins decided to move back home to Connecticut. Collins decided to open a new restaurant—the Georgetown Saloon—with Manere and two other associates. The saloon proved unsuccessful and closed about one year later, but operating the saloon gave Collins firsthand exposure to Manere's management style. Collins became concerned by what he saw and started to take a more active interest in Manere's handling of the café's finances. Unsurprisingly, Manere resisted Collins's newfound focus and provided incomplete or irrelevant information. Collins persisted and was able to cobble together a rough picture of the café's finances, which revealed that Manere had misappropriated approximately \$190,000.

Collins responded forcefully. First, he unilaterally amended BAHR's operating agreement to terminate Manere as a manager. Next, he fired Manere's son, who was working at the café as a bartender. Finally, Collins removed Manere as one of the café's liquor permittees and changed the café's locks.

After pushing Manere aside, Collins took over direct management of the café, and revenue increased by about 25%. Other than a weekly salary of \$1,000 to Collins, no payments or distributions were made to either Collins or Manere after Collins took over management of the café. Additionally, Collins did not provide Manere any financial information concerning BAHR's finances as required by the operating agreement. In response, Manere sued both Collins and BAHR. In particular, Manere asserted claims for breach of contract against both and claims for breach of fiduciary duty and oppression against Collins. Furthermore, Manere requested that the court dissolve BAHR for oppression. In its response, BAHR counterclaimed against Manere based upon Manere's misappropriation of LLC funds.

After a two-day bench trial, the trial court rendered judgment in favor of Collins and BAHR on all of Manere's asserted claims. The trial court also awarded BAHR over \$190,000 in damages on its counterclaim. Manere appealed on three grounds. First, Manere argued that BAHR's counterclaim failed to state a claim under Connecticut law because misappropriation is not an independent cause of action in Connecticut and a claim for breach of fiduciary duty must be pled with specificity. Second, Manere argued that the court erroneously applied the six-year statute of limitations to BAHR's claim. Finally, Manere asserted that the trial court improperly rejected Manere's application to dissolve BAHR for oppression.

The court concluded that Manere's first point argued mere semantics. Although BAHR never explicitly stated that it was countersuing for breach of fiduciary duty, Connecticut courts are not bound by the labels affixed by the pleading parties when interpreting pleadings. BAHR's pleading sounded in breach of fiduciary duty and alleged facts consistent with a breach-of-fiduciary-duty cause of action. Second, given that BAHR's counterclaim was an action for breach of fiduciary duty rather than an action for an accounting, the trial court should have applied the three-year statute of limitations applicable to torts rather than the six-year statute of limitations. Because there were fact issues relating to the question of whether Manere's tortious conduct fell within the three-year statute of limitations, remand for further proceedings to resolve those fact issues was required.

The court then addressed Manere's assertion that the trial court improperly rejected his application to dissolve BAHR for oppression. The court began its lengthy discussion of the oppression doctrine by noting that the Connecticut Uniform Limited Liability Company Act does not define "oppression" and its legislative history sheds little light on the intended definition. The court thus turned to other extratextual sources of guidance. After describing the history and evolution of the oppression doctrine in the corporate context, the court pointed out that Connecticut substantially adopted the major provisions of the Revised Uniform Limited Liability Company Act. The court thus found it appropriate to look to the RULLCA comments for guidance. Those comments state that, although the Revised Uniform Limited Liability Company Act does not define the term "oppressive," the term is well-grounded in close corporation law.

The court pointed out that the Connecticut Supreme Court recently defined "oppression" as used in the Connecticut Business Corporation Act to encompass both: (1) behavior by the corporation's controller that suggests a lack of probity and a departure from fair dealing; and (2) conduct that substantially defeats the minority shareholder's reasonable expectations. The court recognized, however, that there is an inherent tension between the "fair dealing" and "reasonable

expectations” standards. On the one hand, the court noted that the “fair dealing” standard primarily focuses on maintaining the majority’s discretion to make decisions that further a legitimate business purpose. Thus, although the majority’s decision may impose an outsized negative impact on the minority, a decision will not be oppressive under the “fair dealing” standard if the decision benefits the corporation as a whole. In this regard, the “fair dealing” standard treats close corporations similarly to public companies in that maximizing shareholder value is the ultimate goal. On the other hand, the “reasonable expectations” standard looks at the issue from the minority shareholder’s perspective. Under this approach, conduct is oppressive if it substantially defeats the reasonable expectations that a minority shareholder held when he or she decided to join the venture. As a result, the “reasonable expectations” standard pays deference to the fact that the shareholders in close corporations may have expectations that are substantially different than the shareholders in a public company. In particular, shareholders in close corporations typically expect to actively participate in the management and operations of the enterprise.

The court elected to adopt the “reasonable expectations” approach. First, the RULLCA comments emphasize that in most jurisdictions, “oppression” refers to the frustration of a member’s reasonable expectations, and the guidance provided in the comments for assessing oppression claims is consistent with this view. Furthermore, the court noted that the “reasonable expectations” view is the majority view in the close corporation context because it is more consistent with the nature of a closely held company. The court determined that the considerations that make the “reasonable expectations” approach more appropriate in the corporate context are equally applicable to limited liability companies. Thus, the court held that Connecticut courts should look to the minority member’s reasonable expectations when determining if the majority engaged in oppressive behavior.

Having adopted a new standard, the court felt that it was prudent to elaborate on the contours of the “reasonable expectations” doctrine. First, the court favorably referenced the factors set forth in the RULLCA comments, which include “whether the expectation: (i) contradicts any term of the operating agreement or any reasonable implication of any term of that agreement; (ii) was central to the plaintiff’s decision to become a member of the limited liability company or for a substantial time has been centrally important in the member’s continuing membership; (iii) was known to other members, who expressly or impliedly acquiesced in it; (iv) is consistent with the reasonable expectations of all the members, including expectations pertaining to the plaintiff’s conduct; and (v) is otherwise reasonable under the circumstances.”

Next, the court expressly recognized that employment and involvement in the company’s management are often reasonable expectations of a minority member. Nonetheless, the court also recognized that a member’s reasonable expectations at the inception of an LLC might not remain reasonable over time. In particular, an initially reasonable expectation of continued employment and involvement in management can be vitiated by that member’s misconduct or incompetence. The court also mentioned that a court could find that a minority member’s reasonable expectation has been forfeited if the minority member fails to actively pursue that reasonable expectation. Finally, the court recognized that a causal connection is required between the oppressive conduct and the harm suffered by the plaintiff-member.

With this framework in mind, the court turned to Manere’s assertion that the oppressive conduct of Collins justified dissolving BAHHR. Here, the court drew a line between the decision to fire Manere and the other actions taken by Collins (such as suspending member distributions). The court held that a new trial on Manere’s termination of employment was unwarranted because the trial court had already determined that Manere had misappropriated BAHHR’s funds. But Manere’s

misconduct did not grant Collins and Bahr a license to marginalize Manere in such a way that he was deprived of any remaining reasonable expectations. Although Collins and Bahr were justified in terminating Manere's employment and depriving him of unfettered access to the café and its bank accounts, Manere was still entitled to realize whatever remaining reasonable expectations he had as a minority member, including a means to share in the company's profits. Because the trial court did not adequately consider whether Collins and Bahr had defeated Manere's remaining reasonable expectations, the court determined that a new trial was warranted.

*Benjamin v. Bierman*, 943 N.W.2d 283 (Neb. 2020).

In an action by a deceased member's personal representative seeking judicially ordered dissolution of two LLCs and asserting breach of contract by the surviving members based on their failure to buy out the deceased member's interests, the Nebraska Supreme Court held that the personal representative lacked standing to seek dissolution of LLCs because she was not a member.

Mark Benjamin owned a one-half interest in Sixth Street Rentals, LLC ("Rentals") along with Doug Bierman and a one-third interest in Sixth Street Development, LLC ("Development") along with Doug Bierman and Doug's father, Eugene Bierman. Mark passed away on April 14, 2015, leaving his wife Brenda Benjamin as his primary beneficiary and the personal representative of his estate. Prior to his death, Mark was acting manager of both LLCs. After Mark's death, Doug took over the manager position for both LLCs.

Counsel for both Rentals and Development sent notices to Brenda pursuant to the respective separate but identical operating agreements, stating the LLCs' intention to buy Mark's interests. Brenda testified at trial that she and Doug had generally reached an agreement pursuant to which Doug would buy out Mark's interest in Rentals, and Doug and Eugene would buy out Mark's interest in Development. Brenda would receive Development's interest in a store facility jointly owned by Development, a third party, and Mark's estate as an offset for the purchase price for Mark's interest in Development.

The parties agreed to close on the buyouts of Mark's interests in Rentals and Development as well as a corporation in which Mark owned shares on April 15, 2016. The parties had valuations done on Rentals and Development by Terry Galloway. The parties did not close on the specified date, and Brenda sued the Biermans and the LLCs on June 1, 2016. After a bench trial, the trial court found that the Biermans, Rentals, and Development had breached the operating agreements of Rentals and Development, ordered an accounting for each company, declined to dissolve either, and awarded Brenda damages.

Brenda appealed the trial court's decision not to order dissolution of both Rentals and Development. The Biermans, Rentals, and Development (collectively, the "Bierman parties") cross-appealed alleging numerous points of error. The court grouped the Bierman parties' points of error into the following categories: assignments of error related to fair market value, assignments of error related to breach of contract and specific performance, and remaining assignments of error.

The court first dealt with Brenda's appeal. Brenda based her argument on Neb. Rev. Stat. 21-147(a), which states in part:

A limited liability company is dissolved, and its activities must be wound up, upon the occurrence of any of the following:

...

(4) on application by a member, the entry by the district court of an order dissolving the company on grounds that:

...

(B) it is not reasonably practicable to carry on the company's activities in conformity with the certificate of organization and the operating agreement; or

(5) on application by a member, the entry by the district court of an order dissolving the company on the grounds that the managers or those members in control of the company:

...

(B) have acted or are acting in a manner that is oppressive and was, is, or will be directly harmful to the applicant.

The court did not address the merits of the claims under these two subsections. Instead it focused on the fact that Brenda lacked standing to request dissolution since she was not a member of either LLC.

The Nebraska Uniform Limited Liability Company Act defines a member as “a person that has become a member of a limited liability company under section 21-130 and has not dissociated under section 21-145.” Section 21-145 provides that a person is “dissociated as a member from a limited liability company” upon the death of that person. The court held that Mark ceased to be a member of each LLC upon his death and explained that a member’s right to participate as a member in the management and conduct of the company’s activities terminates upon dissociation of the member. The deceased member’s personal representative may only exercise the rights of a transferee provided in the statute and, for purposes of settling the estate, certain rights (primarily the right to have access to records or other information concerning the company’s activities) of a current member. Since Brenda was not a member, she did not have the right to seek dissolution under the statute.

The court also rejected Brenda’s argument that the operating agreement granted Mark the power to transfer governance power, along with his economic interest, in Rentals and Development. The provision relied upon by Brenda provided:

Any Member may transfer by gift or bequest all or any portion of his or her interest in the Company to a spouse or child of the transferring Member, or to a trust established for the benefit of such spouse or child, or to an existing Member of the Company upon written notice to the Company, of such gift or bequest.

The court interpreted the plain language of this section as permitting the transfer of some or all of a member’s or dissociated member’s interest in an LLC by gift or bequest, noting that the Nebraska LLC statute provides that an interest in an LLC is personal property that is transferable. But the court pointed out that the transfer of an interest is accompanied by limited rights, as previously discussed by the court, and the court did not read the language of the operating agreements as broadening the rights accompanying the interest to include governance power or any other power beyond that provided by the statute.

***Dystart v. Dragpipe Saloon, LLC***, 933 N.W.2d 483 (S.D. 2019).

The South Dakota Supreme Court held that judicial dissolution of an LLC was not warranted where the LLC operating agreement contained a broad purpose clause that included the LLC’s

activities, the LLC had begun to show a modest profit in recent years, the members' failure to agree on the sale of the LLC's property did not prevent the LLC from continuing to operate consistent with its stated purpose or frustrate its economic purpose, and there was no impenetrable deadlock that resulted in one faction of members benefitting to the prejudice of the others.

Four individuals formed Dragpipe Saloon, LLC ("Dragpipe") in 2003, and each received a 25% membership interest and voting rights. Dragpipe purchased 74 acres of land near Sturgis, South Dakota, and built a bar that is open only during the Sturgis Motorcycle Rally. About eighteen acres were used for the bar, and the remaining acreage was leased to a farmer and later used by the LLC as a campground. Beginning in 2004, Dragpipe was open during the annual motorcycle rallies, selling beverages and t-shirts, hosting food vendors, and providing live entertainment.

After the 2015 rally, two of the members advised the other two members that they wanted to sell their membership interests. The non-selling members did not object, but the members who wanted to sell their interests were unsuccessful. In early 2017, three of the members signed an agreement with a real estate agent intending to offer to sell the Dragpipe property. The fourth refused to sign the agreement.

Two of the four members of Dragpipe sought judicial dissolution and an order authorizing the sale of Dragpipe's assets. Under the South Dakota Limited Liability Company Act, an LLC is dissolved "on application by a member...upon entry of a judicial decree that (i) the economic purposes of the company is likely to be unreasonably frustrated...[or] (iii) it is not otherwise reasonably practicable to carry on the company's business in conformity with the articles of organization and its operating agreement." Following a trial, the circuit court ordered dissolution and the sale of Dragpipe's assets. The other members appealed, arguing that the circuit court erred in concluding that it was not reasonably practicable for Dragpipe to continue in accordance with the provisions of its operating agreement and that Dragpipe's economic purpose was unreasonably frustrated.

Dragpipe's operating agreement stated that the LLC's purpose was "to engage in all lawful activities, including, but not limited to, owning, purchasing, taking, leasing, or otherwise holding or acquiring real property and any interest or right in real property and any improvements thereon, and to hold, own, operate, control, maintain, manage and develop such property and interests in any manner that may be necessary, useful or advantageous...[to the] company." The court noted that Dragpipe's purpose was very broad, and included purchasing real property and holding, owning, operating, maintaining and managing such property, which was essentially what Dragpipe had done since its formation and continued to do. The court stated that the members who sought dissolution may "have grown weary of Dragpipe's lukewarm revenue" over the years, but that did not itself indicate the LLC was not carrying on its business in conformity with the operating agreement. In addition, the two members' desire to sell Dragpipe's real property and realize the gain from their investments did not mean Dragpipe was unable to continue to operate in accordance with its stated purposes.

The supreme court also found that the circuit court erred in its determination that the economic purpose of Dragpipe was likely to be unreasonably frustrated. Without judicial dissolution, the court believed Dragpipe would continue to operate as it had in the past. Even if sale of the property was the most likely means of making money for Dragpipe's members, the members' failure to agree about the sale of the property did not mean that the economic purpose of Dragpipe was likely to be frustrated. The court noted that the members who sought dissolution had the right under



the operating agreement to resign and receive the fair market value of their interests, but they did not attempt to avail themselves of that option.

Finally, the court also noted there was no “impenetrable deadlock” among the members and that it did not appear that one faction of members was benefitting from the disagreement relating to the sale of Draggpipe’s real estate to the prejudice of the other members. Also, the parties worked together at the 2017 rally, suggesting there was no impenetrable deadlock.

In sum, the court concluded that the “drastic remedy” of judicial dissolution was not supported and reversed the circuit court’s judgment.

## **Winding Up**

*Deschamps v. Farwest Rock, Ltd.*, 474 P.3d 1282 (Mont. 2020).

The court held that neither the LLC plaintiff named in the complaint nor the sole member of the LLC had standing to pursue a claim for breach of a contract entered into in the name of the LLC. The LLC that had entered into the contract dissolved and had completed its winding up as a matter of law; therefore, the LLC did not have standing to assert the claim for breach of its contract. A more recently formed LLC by the same name had no standing to sue because it was not the entity that had entered into the contract. Finally, the sole member of the dissolved LLC (and of the more recently formed LLC) did not have standing because he was neither a party nor a third-party beneficiary to the contract.

Alfred Deschamps owned a property with a gravel pit. Deschamps wanted to execute a mineral lease for his gravel. To limit his liability under the mineral lease, Deschamps formed Bar 11 Enterprises, LLC (Bar 11) in 2003. Deschamps was Bar 11’s sole member and agent. Bar 11 entered into a gravel mining lease with Farwest Rock, Ltd. (Farwest) in 2006. Farwest’s president—Mike Baston—obtained the necessary environmental permits to begin gravel mining.

Five years later, Bar 11 entered into a sublease with Farwest Rock Products (Farwest Products)—a company owned by Mike Baston’s son, Lunde. Deschamps signed the lease contract in his capacity as Bar 11’s agent. The sublease provided that Farwest Products would make monthly royalty payments to Bar 11. In practice, Farwest Products tendered payment to Bar 11 and Deschamps interchangeably. After about six months of mining, Lunde Baston determined that there was too much clay in the soil to economically extract gravel. As a result, Farwest Products ceased operations in early 2012 and removed its remaining equipment by June.

About six months later, on December 3, 2012, the Montana Secretary of State’s office involuntarily dissolved Bar 11 for failing to file its annual reports. Deschamps was oblivious to the change in affairs. On October 16, 2015, nearly four years after mining operations ceased and nearly three years after the Secretary of State dissolved Bar 11, Deschamps’ attorney sent Lunde Baston and Farwest Products a Notice of Default and demand for unpaid royalties. Baston responded two weeks later by sending Deschamps a Notice of Termination of Lease, citing economic unfeasibility.

On December 10, 2018, Deschamps filed suit against the Bastons and the Farwest Rock entities. Deschamps—who remained oblivious to Bar 11’s dissolution—named both himself and Bar 11 as plaintiffs. Only Lunde Baston and Farwest Products were properly served. On September 3, 2019, Deschamps finally learned during a deposition that the Secretary of State had dissolved Bar 11 almost seven years earlier. That same day, Deschamps filed articles of organization for an entity named Bar 11 Enterprises, LLC. But the significance of the original Bar 11’s dissolution was not lost on Baston and Farwest Products. Both moved to dismiss for lack of standing.

The trial court granted both motions to dismiss. The trial court concluded that the new Bar 11 lacked standing because it was a distinct entity from the original Bar 11, and the breach-of-contract claim belonged to the original Bar 11. The trial court concluded that the original Bar 11 lacked standing because six years between its dissolution and the filing of the lawsuit exceeded a reasonable amount of time for it to wind up its affairs. Finally, the trial court determined that Deschamps lacked standing because he did not sign the lease agreement in his individual capacity, and he was not a third-party beneficiary of the contract. Deschamps and Bar 11 appealed.

The Supreme Court of Montana first discussed the original Bar 11. Deschamps argued that the original Bar 11 could still pursue its claim because the Montana Limited Liability Company Act provides that a dissolved LLC can bring suit as part of its winding-up process. Deschamps argued that the trial court drew an arbitrary, bright-line rule when it determined that five years was a reasonable period of time for Bar 11 to wind up in the face of the statute's silence as to how long a winding up should last. Deschamps further asserted that the reasonableness of the period of time leading up to the lawsuit was a fact question for a jury to decide.

The court was unpersuaded. Although the court recognized that the role of the judiciary is to ascertain and declare the intent of the legislature, the court did not accept that the legislature's failure to include an express time measurement for the wind-up period indicated that the legislature intended for the wind-up period to last forever. Importantly, the legislature gave administratively dissolved LLCs five years to seek reinstatement. The court determined that a similar duration was warranted for conducting winding up. As to whether the courts should determine as a matter of law how long an LLC has to conduct its winding up, the court pointed to authority in the corporate context stating that the issue is generally one of law, rather than fact. The court saw no reason why limited liability companies should be any different. Therefore, the original Bar 11 no longer existed and had completed its winding up as a matter of law.

Deschamps asserted that the original Bar 11 was reinstated when he created a business entity by the same name during the litigation. Because Deschamps formed a new entity more than six years after the dissolution of the original Bar 11, and did not claim to have followed the procedural requirements for reinstating an administratively dissolved LLC within five years after dissolution, the court stated that the trial court correctly concluded that Deschamps had merely created a new entity with the same name as a previously dissolved entity rather than reviving the entity that was a party to the contract at issue. Thus, the new Bar 11 was not a party to the contract at issue and lacked standing to sue Baston and Farwest Products.

Finally, the court held that Deschamps did not have standing to pursue the claims in his individual capacity. Deschamps signed the contract in his capacity as a Bar 11 agent. Further, the contract did not indicate that Deschamps or anyone else was an intended third-party beneficiary of the contract. Montana courts are reluctant to find third-party beneficiaries absent an express designation in the contract. Neither the fact that Deschamps sometimes received royalty payments directly nor the fact that Deschamps was Bar 11's sole member was sufficient to establish his status as a third-party beneficiary. Because Deschamps was neither a party nor a third-party beneficiary to the contract between Farwest Products and Bar 11, he lacked standing to pursue the claim.

Because none of the potential plaintiffs had standing to pursue the claim, the court concluded that the trial court correctly granted summary judgment.

## **Derivative Suits**

***Wilson v. Gandis***, 844 S.E.2d 631 (S.C. 2020).

The South Carolina Supreme Court affirmed the trial court's finding that two members owning 55% of the membership of an LLC oppressed the remaining member pursuant to a "tightly controlled cabal to oust [the minority member] that could serve as a script for minority oppression." The court held that the majority lacked standing to bring their claims against the minority member for breach of fiduciary duty because they asserted the claims individually rather than derivatively.

David Wilson, John Gandis, and Andrea Comeau-Shirley were members of Carolina Custom Converting, LLC (CCC). CCC was formed by Gandis and Wilson in 2007 as a manager-managed LLC with each owning a 50% membership interest. Gandis served as president and manager, and Wilson served as vice-president. In 2008, Gandis engaged Shirley, a CPA, to provide CCC with accounting and formation advice. In 2009, Gandis and Wilson each transferred a 5% interest in CCC to Shirley in exchange for her services. After reviewing the law and evidence regarding Wilson's minority member oppression claim, the supreme court agreed with the trial court that Gandis's and Shirley's efforts were a "tightly controlled cabal to oust Mr. Wilson [that] could serve as a script for minority [ ] oppression" and concluded that the record was replete with evidence of "freeze out" maneuvers on the part of Gandis and Shirley. The court then briefly discussed the claim of Gandis and Shirley against Wilson for breach of fiduciary duty. Gandis and Shirley alleged in their counterclaim that Wilson breached fiduciary duties owed to CCC and to them by (1) usurping CCC's business opportunities and engaging in secretive side deals; (2) misappropriating CCC's alleged trade secrets and confidential information; and (3) destroying evidence on CCC's laptops and Blackberry. Because CCC would have sustained any financial loss caused by Wilson's alleged actions, the court held that Gandis and Shirley lacked standing to bring a breach-of-fiduciary-duty claim in their individual capacities. On the merits, the court found that the trial court correctly concluded Wilson did not breach any fiduciary duties owed to Gandis and Shirley.

***Homapour v. Harounian***, 182 A.D.3d 426 (N.Y. App. Div. 2020).

The appellate court affirmed as modified the trial court's order that dismissed certain derivative claims against a member, one group of LLCs, and counsel representing another group of LLCs. In modifying that order, the court held as follows: (1) a six-year statute of limitations governed the derivative claims for breach of fiduciary duty and waste against the member; (2) the "open repudiation" doctrine tolled any limitations period applicable to those derivative claims against the member; (3) the trial court erred in dismissing the derivative claim for a constructive trust against the member and one group of LLCs; (4) the plaintiff-member adequately stated derivative claims for breach of fiduciary duty as well as aiding and abetting breach of fiduciary duty against counsel for the other group of LLCs; (5) a six-year statute of limitations governed the derivative claims against counsel; and (6) the continuous representation doctrine did not toll the limitations period for the derivative claims against counsel.

Mehrnaz Nancy Homapour, her brother and defendant Mark Harounian, and other family members formed sixteen LLCs (the "Family LLCs"). Homapour brought this action against Harounian, the Family LLCs, several LLCs presumably under Harounian's control (the "Harounian LLCs"), and counsel representing the Family LLCs, asserting multiple derivative claims on behalf of the Family LLCs. Harounian, the Family LLCs, and the Harounian LLCs filed a motion to dismiss the derivative claims for breach of fiduciary duty and waste against Harounian as barred by a

three-year statute of limitations. They also sought dismissal of the derivative claim for a constructive trust against Harounian and the Harounian LLCs and dismissal of part of the derivative unjust enrichment claim that sought a declaration as to the Family LLCs' interest in real estate that Harounian purchased. Counsel for the Family LLCs also filed a motion to dismiss the derivative claims for breach of fiduciary duty as well as aiding and abetting breach of fiduciary duty as barred by a three-year statute of limitations. After the trial court granted both motions, Homapour appealed.

The appellate court held that a six-year statute of limitations applied to the derivative claims for breach of fiduciary duty and waste against Harounian for two reasons, each supported by New York case law. First, the court concluded that, while these claims were not fraud-based, Homapour did seek both money damages and equitable relief, "i.e., a constructive trust, an injunction, and an accounting." Second, the court stated that derivative claims are governed by a six-year limitations period because they are "equitable in nature." The appellate court also held that "[i]n any event, the 'open repudiation' doctrine applies to toll any applicable statute of limitations, because Harounian continues to be in a fiduciary relationship with the Family LLCs."

Next, the court concluded that the trial court erred in dismissing the derivative claim for a constructive trust against Harounian and the Harounian LLCs. The court again cited New York case law for the proposition that a constructive trust is an equitable remedy and its purpose is to prevent unjust enrichment. The court determined that the complaint sufficiently alleged that Harounian misappropriated the Family LLCs' funds to acquire real property for his own personal benefit, which was purportedly owned by the Harounian LLCs. The appellate court also concluded that the trial court correctly dismissed the part of the derivative unjust enrichment claim seeking a declaration that "the Family LLCs are entitled to a pro rate ownership interest in the real estate that Harounian purchased" under New York's statute of frauds.

Finally, the appellate court held that Homapour adequately stated derivative claims for breach of fiduciary duty as well as aiding and abetting breach of fiduciary duty and that these claims were governed by a six-year statute of limitations. The court reasoned that the complaint stated a claim for breach of fiduciary duties because Homapour alleged that counsel, while retained by the Family LLCs, began acting as attorney for Harounian personally without disclosure to the Family LLCs and inserted unilateral changes into operating agreements that favored Harounian's personal interests over those of the Family LLCs. Similarly, the court found that Homapour stated a claim for aiding and abetting breach of fiduciary duty by alleging that counsel for the Family LLCs assisted Harounian in making those unilateral changes to the operating agreements and appended Homapour's signature pages to the altered agreements as part of Harounian's scheme to misappropriate funds from the Family LLCs. The court concluded that the six-year limitation period applied to the derivative claims against counsel for the Family LLCs for the same reasons it applied to the derivative claims against Harounian, i.e., although the claims were not fraud-based, Homapour sought both money damages as well as equitable relief and the claims were derivative. The appellate court further held, however, that Homapour's reliance on the continuous representation doctrine in arguing for a global tolling of the statute of limitations was misplaced because each Family LLC was a discrete client.

***In re Murrin Bros. 1885, Ltd.***, 603 S.W.3d 53 (Tex. 2019).

The Texas Supreme Court held that the trial court did not abuse its discretion in refusing to disqualify counsel from continuing its representation of both the defendant ownership faction and the LLC in a derivative suit brought by another ownership faction. The court also held that the relator

did not establish that it lacked adequate remedies to redress the denial of the relator's Rule 12 motion requiring counsel for the LLC to show its authority to represent the LLC.

In 2011, the three original owners of Billy Bob's, a historic entertainment venue in the Fort Worth Stockyards, brought in additional owners and collectively formed Bill Bob's Texas Investments (BBT), a closely held LLC, to own and manage Billy Bob's. BBT's owners adopted a company agreement providing for BBT's structure and containing rules for its management. One provision of the company agreement required unanimous consent of the owners for any "matter within the scope of any major decision." The "major decisions" requiring unanimous consent included "settling, prosecuting, defending or initiating any lawsuit, administrative or similar actions concerning or affecting the business of BBT LLC and/or the BBT LLC Property." After the owners adopted the company agreement, a certificate of formation was filed with the Secretary of State. The certificate of formation lists six "Governing Persons" of BBT, all of whom are either owners of BBT or closely related to an owner or ownership entity. Concho Minick, an owner and governing person, was unanimously elected president and managing member with "full power and authority to make and carry out all decisions in connection" with "the ordinary, daily and routine business affairs of BBT."

In 2017, several owners and governing persons (nine of twelve owners and four of six governing persons, the "Hickman Group") became dissatisfied with Minick and attempted to dismiss him by a majority vote of the governing persons. Three owners, Minick, Murrin Brothers 1885, Ltd., and ERI-BBTX, LLC (the "Murrin Group") opposed Minick's removal, arguing that Minick's dismissal was a "major decision" for which the company agreement required a unanimous vote of the owners. Murrin Brothers 1885, Ltd. then filed a lawsuit, asserting both individual and derivative claims against the Hickman Group. The Murrin Group also sought injunctive relief to deny the Hickman Group the ability to unilaterally remove Minick, a declaration that the Hickman Group was without authority to oust Minick, and appointment of a receiver. The Hickman Group hired counsel to represent both BBT and the Hickman Group, and the Hickman Group filed counterclaims asserting both individual and derivative counterclaims and requesting appointment of a receiver.

About three months before trial, the Murrin Group filed a motion to disqualify the Hickman Group's attorneys, alleging that their representation of both the Hickman Group and BBT amounted to the impermissible representation of both sides in the same case (because BBT was the "plaintiff" in the Murrin Group's derivative claims against the Hickman Group). The Murrin Group later filed a Rule 12 Motion, requiring the Hickman Group's attorneys to show its authority to represent the LLC. The Rule 12 motion argued that the decision to hire counsel on behalf of BBT was a "major decision" requiring unanimous consent of the owners. The Hickman Group responded that the certificate of formation granted them authority to hire counsel for BBT with a simple majority of the governing persons. The trial court denied both motions. After the court of appeals denied mandamus relief to the Murrin Group, the Murrin Group sought mandamus relief from the Texas Supreme Court on both motions.

With respect to the motion to disqualify, the Murrin Group argued that BBT and the Hickman Group were directly adverse, i.e., opposing parties, because BBT is the plaintiff in this derivative action and the Hickman Group are defendants. The court stated that the classification of the company in a derivative action is not that simple:

The battle lines are not so clear, however. Shareholder derivative actions provide a procedural pathway for a minority shareholder to sue on behalf of the company for

wrongs committed against the company. *Sneed v. Webre*, 465 S.W.3d 169, 182–83 (Tex. 2015); *Eye Site, Inc. v. Blackburn*, 796 S.W.2d 160, 162 (Tex. 1990); see also TEX. BUS. ORGS. CODE §§ 21.552, 101.452 (outlining requirements for derivative suits). Because the suit is to vindicate the company’s rights, it is often said that the company is a “plaintiff” in a derivative action. See, e.g., *Ross v. Bernhard*, 396 U.S. 531, 538, 90 S.Ct. 733, 24 L.Ed.2d 729 (1970); *Clark v. Lomas & Nettleton Fin. Corp.*, 79 F.R.D. 658, 659 (N.D. Tex. 1978); *Nat’l Bankers Life Ins. Co. v. Adler*, 324 S.W.2d 35, 36 (Tex. Civ. App.—San Antonio 1959, no writ); cf. *In re Schmitz*, 285 S.W.3d 451, 452 (Tex. 2009) (orig. proceeding). Labeling the company a “plaintiff” does not tell the whole story, however. Most companies begin derivative litigation resistant to the minority shareholder’s derivative claims. The resistance of the company’s usual decisionmakers to the minority shareholder’s claims is what causes derivative litigation in the first place. For this reason, in addition to sometimes being called plaintiffs, companies embroiled in derivative litigation are also commonly called “nominal defendants.” See, e.g., *Meyer v. Fleming*, 327 U.S. 161, 167, 66 S.Ct. 382, 90 L.Ed. 595 (1946); *Bankston v. Burch*, 27 F.3d 164, 167 n.10 (5th Cir. 1994); *Neff ex rel. Weatherford Int’l, Ltd. v. Brady*, 527 S.W.3d 511, 518 (Tex. App.—Houston [1st Dist.] 2017, no pet.). Thus, companies in derivative litigation are simultaneously “plaintiffs” and “defendants,” depending on how you look at it. Of course, if the company is literally both plaintiff and defendant, then no lawyer could ever represent it in derivative litigation because to do so would automatically place the lawyer on both sides of the case. Obviously, that is not the rule.

The court said that rather than focusing on which party label applies to a company in derivative litigation, “the proper inquiry is to look to whether the substance of the challenged representation requires the lawyer to take conflicting positions or to take a position that risks harming one of his clients.” The court noted a division of authority around the country as to whether such a risk is always present in derivative litigation, with some courts concluding that representation of both the company and the insider defendants is categorically impermissible, while other courts, including courts in Delaware, have taken a more practical approach and have reasoned that the interests of the company and its controlling officers or directors are often aligned such that separate counsel is not necessary unless a divergence of interests arises.

The court declined to announce a categorical rule governing dual representation in derivative litigation:

Whether a company and the individual defendants are “opposing parties” for purposes of Rule 1.06(a) in derivative litigation requires consideration of the true extent of their adversity under the circumstances. The definition of “directly adverse” representation provided in the comments to the disciplinary rules provides useful guidance in derivative litigation, as elsewhere:

Within the meaning of Rule 1.06(b), the representation of one client is directly adverse to the representation of another client if the lawyer’s independent judgment on behalf of a client or the lawyer’s ability or willingness to consider, recommend or carry out a course of

action will be or is reasonably likely to be adversely affected by the lawyer's representation of, or responsibilities to, the other client. The dual representation also is directly adverse if the lawyer reasonably appears to be called upon to espouse adverse positions in the same matter or a related matter.

TEX. DISCIPLINARY RULES PROF'L CONDUCT R. 1.06 cmt. 6.

The court stated that, not surprisingly, each faction claimed to be aligned with BBT and acting on its behalf while arguing that the other faction's positions are incorrect and harmful to BBT. According to the court, "[s]tripped of the conceptual and procedural baggage of its 'derivative' claims, this case is about who controls the management of BBT—the Hickman Group by virtue of its majority interest, or the Murrin Group by virtue of the Company Agreement's unanimity provision. Either the Hickman Group is right, in which case its interests and BBT's are truly aligned, or the Murrin Group is right, in which case BBT is aligned with it instead."

The court also pointed to the provisions of the Texas Business Organizations Code governing derivative suits on behalf of closely held LLCs:

Perhaps anticipating suits like this one—control-fights between LLC members couched as derivative actions—the legislature has provided that "if justice requires: a derivative proceeding brought by a member of a closely held limited liability company may be treated by a court as a direct action brought by the member for the member's own benefit." TEX. BUS. ORGS. CODE § 101.463(c). For purposes of the disqualification motion, the trial court could have treated the derivative claims as claims "brought by the member for the member's own benefit," rather than disqualifying KHH based on the procedural complexities introduced by the derivative claims. Indeed, if the derivative claims are treated as direct claims, as the statute permits, the Murrin Group's case for disqualification essentially vanishes.

Additionally, the court stated that none of the other "facts and circumstances" presented to the trial court supported disqualification. The case was nearly ready for trial at the time the trial court considered the disqualification motion, and the court said the motion could have been brought much earlier in the litigation. The Hickman Group and the Murrin Group were fully adverse, and both sought to control BBT. The question of which ownership group was entitled to control BBT could be fully and fairly litigated by the parties and counsel currently before the court, and the resolution of it would resolve the troublesome and complex question of BBT's alignment. No showing was made that the Hickman Group's lawyers possessed confidential information belonging to BBT that prejudiced the Murrin Group and could not otherwise have been obtained from the Hickman Group. The court stated that all these facts and circumstances supported the trial court's decision not to disrupt the current alignment of parties and counsel on the eve of trial.

Finally, the court addressed the Murrin Group's contention that allowing the Hickman Groups lawyers to represent both BBT and the Hickman Group would confuse the jury by creating the false impression that the Hickman Group speaks for BBT or that the two are one and the same. Even assuming the validity of this concern, the court said there were less severe remedies than disqualification, such as jury instructions or other parameters for the conduct of trial that would ensure an even playing field. Characterizing the dispute as "a fairly straightforward case about which

ownership group controls the company’s decisions,” the court said that it was unlikely the jury would have any problem identifying the two ownership groups and their counsel, and it was unclear to the court why a jury would need to be told anything about the question of which lawyers have authority to represent the company itself. The court also found it unclear how the answer to that question would have any practical impact on the case.

In sum, the court concluded that the trial court did not abuse its discretion by denying the motion to disqualify.

The court next turned to the Murrin Group’s Rule 12 motion. Rule 12 of the Texas Rules of Civil Procedure provides that a party, upon a sworn motion stating the moving party’s belief that the suit is being prosecuted or defended without authority, may cause an attorney to show authority to act. The burden of proof is on the challenged attorney to show sufficient authority to prosecute or defend the suit. In support of its Rule 12 motion, the Murrin Group argued that the Hickman Group’s lawyers lacked authority to represent BBT because the unanimity requirement of the company agreement prevented the Hickman Group from hiring counsel for BBT. The Hickman Group’s principal response was that the powers afforded governing persons by the certificate of formation constituted “sufficient authority” for a majority of governing persons to hire counsel under these circumstances.

The court first stated that it disagreed with the Murrin Group’s suggestion that the trial court effectively decided the merits of its claims by denying the Rule 12 motion. The trial court’s ruling that the Hickman Group’s lawyers showed “sufficient authority” to represent BBT was not a merits decision on ultimate issues involving the meaning of the company documents and control of the company in the future. Those questions remained for resolution at trial.

Assuming without deciding that the company agreement requires unanimous consent of the owners of BBT to hire counsel as argued by the Murrin Group, the trial court’s abuse of discretion by misinterpreting BBT’s governing documents did not warrant mandamus relief unless the Murrin Group also established its lack of an adequate remedy absent mandamus relief. The Murrin Group alleged that denial of the Rule 12 motion caused three harms that cannot be adequately remedied absent mandamus relief: (1) denial of the Murrin Group’s contractual right to veto BBT’s litigation counsel; (2) jury confusion and prejudice against the Murrin Group if the jury is told that the Hickman Group’s lawyers represent both BBT and the Hickman Group; and (3) payment of the Hickman Group’s legal bills by BBT, thus burdening the Murrin Group’s interest in BBT with payment of their opponent’s legal fees. The court concluded that none of these alleged harms satisfies the lack-of-adequate-remedy requirement. The court said that “[t]he only concrete, non-monetary harms the Murrin Group alleges are the possibility of jury confusion and the unfairness of being made to contribute towards its opponent’s legal bills.” The court pointed out that it had already described how the jury-confusion concern can be remedied, and the court said that adequate remedies exist for breach of contract and recovery of any legal fees that may turn out to have been improperly paid from the Murrin Group’s interest in BBT. Because the Murrin Group did not establish the lack of an adequate remedy if mandamus relief is not granted, the court denied mandamus relief as to the Rule 12 motion.

***Saunders v. Briner***, 221 A.3d 1 (Conn. 2019).

The court held that an individual who was a 50% member of two LLCs (and co-manager of one of the LLCs) did not have standing under either the Connecticut LLC Act (which was based on the ABA Prototype LLC Act) or common law to bring derivative claims on behalf of the LLCs. The



court held that the lower court had discretion to permit the sole member of an LLC to bring a claim that belonged to the LLC as a direct claim, notwithstanding the general rule that the member lacks standing to bring an action for harm suffered only by the LLC, relying on an exception applicable to closely held corporations under the ALI Principles of Corporate Governance.

The plaintiff, a 50% member of two Connecticut LLCs and co-manager of one of the LLCs, brought derivative claims on behalf of the LLCs against the other 50% member, manager, and co-manager. The operating agreements of the LLCs vested management in the managers of the LLCs and did not contain provisions authorizing a member to bring a derivative action. The plaintiff alleged that he adequately represented the interests of the LLCs and had made demands to remedy the issues on which the plaintiff based his claims and that, to the extent he failed to make a formal demand, such a demand was futile.

Although Connecticut adopted the Uniform Limited Liability Company Act in 2017, Connecticut first recognized LLCs in 1993 when it enacted the Connecticut Limited Liability Company Act (CLLCA), which was modeled after the ABA Prototype Limited Liability Company Act (Prototype Act). The CLLCA was in effect when this suit was filed, and the court addressed as a matter of first impression whether the CLLCA provided for member derivative suits absent a provision authorizing such a suit in the operating agreement. On the basis of the plain language of the CLLCA, the court concluded that the CLLCA did not permit members or managers to file derivative actions. Rather, the CLLCA authorized members or managers to collectively commence an action in the name of the LLC upon a requisite vote of disinterested members or managers.

The CLLCA recognized the right of an LLC to sue or be sued and allowed suits to be brought by or against an LLC in its own name. Section 34-187 provided the procedure that members or managers must follow to file a lawsuit in the name of the LLC. Section 34-187(a)(1) and (b) authorized any member, regardless of whether the LLC was member-managed or manager-managed, to bring an action in the name of the LLC upon the vote of a majority of disinterested members. Section 34-187(a)(2) authorized any manager of a manager-managed LLC to bring an action in the name of the LLC upon the vote necessary under § 34-142(a), which required “more than one-half by number of [disinterested] managers ...” The court explained that Connecticut modeled this procedure on § 1102 of the Prototype Act, and the drafters of the Prototype Act made clear that this provision does not permit derivative suits unless they are authorized in the operating agreement. The drafters created a substitute for the derivative action, which they deemed more appropriate “in closely held firms like the typical [limited liability company] ... [in which] members can be expected to be actively interested in the firm, and ... can readily be coordinated for a vote on a suit by the firm.” The court recognized that there may be little difference between the derivative remedy and the one provided by § 1102 of the Prototype Act given the closely held nature of many LLCs, explaining that “[p]ractically, the two types of actions—member initiated and derivative—differ in that, in a derivative action, the parties litigate whether demand was made or whether it was futile and, in a member initiated action, the parties litigate whether a given member’s or manager’s interest was adverse to the company.” Nevertheless, the court concluded that the plaintiff in this case was required to follow the procedure provided by the CLLCA, which was the LLC statute in effect when the action was brought, and the CLLCA required him to allege that he did not need to request a vote of the other 50% member and manager, whose interests were adverse to that of both LLCs. Thus, the plaintiff failed to allege that he undertook the proper procedure to maintain standing under the CLLCA. “Although the allegations set forth in the plaintiff’s second amended complaint—namely, that he was a member or manager of both companies and that either he made demands on [the other

member and manager] or such demands were futile—comport with the procedural requirements for bringing a derivative action under the CULLCA, they do not comply with the requirements for bringing a member initiated action under the CLLCA.”

The plaintiff asked the court to recognize a right on the part of members and managers to sue derivatively under the common law despite the legislature’s omission of a derivative remedy in the CLLCA, but the court concluded that recognition of such a right would conflict with and frustrate the purpose of the CLLCA. The court observed that other Prototype Act jurisdictions have held that members and managers of LLCs must follow the procedure for bringing a member initiated action and lack standing to bring derivative actions under the common law. Thus, the plaintiff did not have standing to sue derivatively under the common law.

Next the court addressed the plaintiff’s direct claims for breach of fiduciary duty and breach of the implied covenant of good faith and fair dealing based on the failure to repay a loan made by the plaintiff’s single-member LLC. The defendants argued that the plaintiff lacked standing to bring a direct claim seeking repayment because he lacked a distinct and separate injury from his LLC, and that the claim must be brought by the plaintiff’s LLC. The plaintiff argued that the general rule should not apply because he financed the loan with his personal capital through his wholly owned company.

The court noted that it had not previously addressed the specific question of whether the member of a single-member LLC has standing to bring an action directly on behalf of the company although the court had previously relied on the direct injury requirements imposed on shareholders to derive the general rule that members of LLCs cannot bring a direct action alleging harm to the company. The court observed that the rule prohibiting shareholders from bringing a direct action to recover for a harm suffered by the corporation addresses the following policy rationales: (1) the protection of other shareholders and creditors of the company; (2) the avoidance of multitudinous litigation; and (3) the equal distribution of recovery to injured parties.

An action brought by one shareholder on behalf of the company or derivative action alleviates the concerns posed by the direct action.

The court discussed exceptions to the corporate rule recognized by courts in some other jurisdictions and the American Law Institute, and those authorities persuaded the court to adopt a “narrowly tailored exception [that] can provide a more flexible mechanism for addressing member standing.” In this regard, the court concluded “that the trial court may permit the member of a single-member limited liability company to bring an action raising derivative claims as a direct action and may order an individual recovery if it finds that to do so will not (1) unfairly expose the company or defendants to a multiplicity of actions, (2) materially prejudice the interests of creditors of the company, or (3) negatively impact other owners or creditors of the company by interfering with a fair distribution of the recovery among all interested parties.” The court determined that the trial court properly exercised subject matter jurisdiction over the plaintiff’s direct claims because the trial court’s exercise of jurisdiction implicitly relied on and was supported by these three factors.

Three justices concurred in part and dissented in part. These justices disagreed with the majority’s decision to adopt the American Law Institute’s approach to close corporation standing to hold that the plaintiff had standing to raise the direct claims relating to his single-member LLC’s loan. The dissent’s reasoning was based on the factual context in which the exception was being applied as well as policy concerns.

***TMX Finance, LLC v. Goldsmith***, 833 S.E.2d 317 (Ga. Ct. App. 2019).

Two ousted members of a Georgia LLC brought a direct action against a third member and several of his entities, alleging that the defendants carried out a takeover scheme by causing a funding crisis. The court of appeals affirmed in part, holding that the ousted members could bring a direct action against the third member and stated claims for breach of the operating agreement, breach of fiduciary duty, fraud, and veil piercing. However, the court reversed in part and held that the third member's alleged breach of fiduciary duties was not a violation of a membership interest purchase agreement.

Dr. Goldsmith, a neurologist who specialized in complex ear procedures, started ICOT Hearing Systems, LLC ("ICOT Hearing") to provide low-cost hearing aids. Jason Jue became involved in the early stages of ICOT Hearing and assisted in building the company into a multimillion-dollar enterprise, running the day-to-day operations as its sole manager. ICOT Hearing was wholly owned by ICOT Holdings, LLC ("ICOT Holdings"). Prior to the events at issue in this case, Goldsmith and Jue together held a majority interest in ICOT Holdings and controlled ICOT Hearing and ICOT Holding (collectively, "ICOT"). Tracy Young founded and controlled the operations of TMX Finance LLC, TitleMax of Texas, Inc., and TitleMax of Georgia, Inc. (collectively, the "TMX Defendants"), which were a "family of companies" consisting of title pawn companies and other businesses.

In August 2015, Young began personally lending money to ICOT. Goldsmith, Jue, and Young shared the goal of selling ICOT to a third party for upwards of "hundreds of millions of dollars in the near term." Young encouraged Jue to "put his foot on the gas" regarding ICOT operations and assured Jue and Goldsmith that he would provide more funding.

In March 2016, ICOT Hearing, ICOT Holdings, Jue, Goldsmith, Young, and Young's limited liability company, TY ICOT Investments ("TY Investments"), entered into a restructuring agreement under which Young loaned additional funds to ICOT Hearing and guaranteed two bank loans (the "Restructuring Agreement"). As part of the restructuring, TY Investments purchased membership units in ICOT Holdings from Goldsmith and minority members and obtained exclusive one-year options to purchase additional units from Goldsmith and minority members. TY Investments' purchase and its options were memorialized in a Membership Interest and Purchase Option Agreement entered at the time of the restructuring of ICOT Holdings (the "Goldsmith Agreement"). As an additional part of the restructuring, ICOT Holdings and its members executed an Amended and Restated Operating Agreement (the "Operating Agreement"), which contained provisions placing certain duties on the company's managers, including the duties to conduct the business in good faith, to not engage in wrongful conduct, and to act in a manner that would not result in improper personal benefit to the managers. The Operating Agreement also provided to TY Investments the power to appoint one of three managers to ICOT Holdings' board of managers. TY Investments then appointed Young, who agreed to comply with the terms of the Operating Agreement while serving in that position. Following the restructuring and prior to execution of the options, Jue and Goldsmith retained their controlling interest in ICOT Holdings. On the other hand, if TY Investments had executed all of the options it acquired as a result of the restructuring, then Young, through TY Investments, would have a majority interest in ICOT Holdings.

In March 2017, Goldsmith and Jue filed a direct action against Young and TY Investments (collectively, the "Young Defendants") and against the TMX Defendants. The plaintiffs' amended complaint included claims for breach of the Operating Agreement, breach of fiduciary duties, breach

of the Goldsmith Agreement, fraud, vicarious liability of the TMX Defendants based on the conduct of their personnel, veil piercing, civil conspiracy, and aiding and abetting a breach of fiduciary duty.

The complaint alleged that, after the restructuring, Young orchestrated the following takeover scheme in order to obtain a controlling interest in ICOT Holdings without having to exercise the options: (1) caused an “existential funding crisis” by derailing funding from third-party capital providers; (2) refused to sign the guarantee for a previously negotiated line-of-credit unless he received warrants from Goldsmith and Jue, resulting in short-term cash flow problems; (3) drove away a third-party buyer with statements that put the company’s financial health in a poor light, disparaged Jue, and threatened to dilute the membership interests of Goldsmith and Jue; (4) initiated an inspection of ICOT’s books and records in preparation for the takeover; (5) leveraged the funding crisis to control ICOT Holdings’ board of managers by appointing an ally, misrepresenting that ally’s appointment was necessary for ICOT Holdings to draw on the line-of-credit; (6) coordinated a vote with the ally to terminate Jue as manager of ICOT Hearing; and (7) diluted Goldsmith and Jue and obtained majority control by issuing a capital call when he knew that the line-of-credit was available and that the plaintiffs lacked the funds to make a pro rata contribution pro rata. After Young took control of ICOT Holdings, he contacted the same third-party buyer and proposed a discounted sale. Considering their diluted position and the discounted sale price, neither Goldsmith nor Jue would receive money from the sale. The defendants answered and later moved to dismiss, contending that the plaintiffs were not entitled to bring a direct claim and had failed to state any viable claims against them. The trial court denied the defendants’ respective motions. The defendants filed applications for interlocutory appeal, which the court granted, leading to the present companion appeals.

The court first considered the Young Defendants’ argument that the plaintiffs’ claims were derivative in nature because they were not separate and distinct from other members of ICOT Holdings and, thus, had to be brought pursuant to the procedural requirements for filing a derivative action under the Georgia Limited Liability Company Act. The court acknowledged the general rule that dilution claims are derivative because they do not constitute a separate and distinct injury but noted an exception where wrongdoers have seized control of the entity by fraud. Because the plaintiffs’ loss of control resulted from Young’s alleged takeover scheme in breach of his fiduciary duties as a manager and through false representations and omissions about funding, the court determined that the plaintiffs could bring a direct claim against the Young Defendants because the alleged harm to plaintiffs was different from that experienced by the company and its minority members and this special injury was sufficiently pled. Furthermore, the court determined that Goldsmith was entitled to bring a direct action for the alleged breach of the Goldsmith Agreement and Jue was entitled to bring a direct action based on his alleged wrongful termination as manager of ICOT Hearing.

### **Charging Order**

*Mattingly Law Firm, P.C. v. Henson*, 466 P.3d 590 (Ok. Ct. App. 2019).

The court held that reverse veil piercing of an LLC is permitted under Oklahoma law and that the facts warranted reverse piercing two LLCs in this case. The court recognized the concept of an equitable owner for veil-piercing purposes such that the two LLCs at issue could be characterized as the alter egos of the non-member spouse of the LLCs’ sole member based on the non-member spouse’s exercise of control over the LLCs.

A law firm (the “Firm”) obtained a default judgment against Melvin Henson in an action for unpaid fees owed by Henson for services provided by the Firm. After multiple hearings where Henson failed to provide evidence of his assets, the trial court ordered Henson to provide “corporate books of any and all LLC[s] [Henson] is associated with, including all records from Henson Farms, LLC and Henson Insurance Group, LLC. Henson to also provide all bank statements in which he has signing privileges.” At a hearing several years after the default judgment was entered, Henson presented the operating agreement for Henson Insurance Group, LLC, bank statements from two bank accounts for the Insurance Group, and statements from one bank account for Henson Farms, LLC. Henson testified that he worked “at the LLCs” but never drew a paycheck from either. He also testified that he sometimes used funds from the LLC bank accounts for personal purposes, but upon further questioning admitted he and his wife essentially “lived out” of the LLC accounts.

The Firm moved for a charging order against Henson’s potential interest in the LLCs. After that motion was filed, Henson was removed from having signing privileges for the bank accounts for both LLCs as a result of a “special meeting” of the LLCs’ sole member—Henson’s wife. At the hearing on the motion for a charging order, the Firm’s counsel testified that the bank account records from the two LLCs revealed that 53% of the account transactions were cash withdrawals, 99% of which were withdrawn by Henson. The Firm’s counsel also testified that the accounts did not reflect any paychecks deposited or paid. Henson and his wife both testified that Henson had never owned an interest in the LLCs and that the LLC bank accounts were not personal in nature. The Firm argued to the trial court that it should be permitted to attach the LLCs’ assets in satisfaction of the judgment against Henson based upon the doctrine of “piercing the corporate veil.” The trial court agreed and granted a charging order against Henson’s “50% interest” in the entities. The trial court also held that the LLCs were “alter egos” of Henson and that the veil of the entities should be pierced.

The court of appeals characterized the “single issue on appeal” as “whether the trial court properly granted the charging order by determining the LLCs were Henson’s ‘alter egos’ and the court should pierce the corporate veil of the entities.” The court began by pointing out that Oklahoma’s LLC statute provides that the exclusive remedy of a member’s creditor with respect to the member’s interest is a charging order that cannot be foreclosed upon, and the Firm relied on “reverse piercing,” a doctrine distinct from traditional piercing of the corporate veil. The court explained that reverse piercing involves holding a business entity—such as an LLC or corporation—responsible for the liabilities of an individual member or shareholder (i.e., the opposite of traditional piercing). The court stated that reverse veil piercing has never been explicitly recognized in Oklahoma in any context, and the Oklahoma Supreme Court has never applied any form of veil piercing to LLCs. The court also stated that Oklahoma has not yet applied corporate veil piercing against an individual who holds no formal financial interest in the business entity.

Henson strenuously argued that he was not a member of either of the LLCs, but was, ostensibly, a manager of the businesses. The court of appeals acknowledged that, under Oklahoma law, charging orders are ordinarily granted regarding a member’s interest in an LLC, and the court stated that non-member managers of LLCs are not traditionally deemed to have a “membership interest” against which a charging order may be granted.

The court of appeals characterized the trial court’s order as “combin[ing] the equitable doctrine of piercing the corporate veil with the statutory mechanism of an LLC charging order” and further explained:

Piercing and reverse piercing of the corporate veil allows an obligee to access all of the assets of the individual or entity on the other side of the veil, treating the pierced entity as synonymous with the obligor-defendant. On the other hand, a charging order allows a creditor to attach only a member's capital interest in an LLC. 18 O.S. Supp. 2017 § 2034. "Membership interest" is defined by statute as "only the flow of profits or surplus from the member's economic interest in his units of the LLC, and only allows this flow until the judgment is satisfied." *Id.*; *Southlake Equip. Co.*, 2013 OK CIV APP 87, ¶ 7, 313 P.3d 289. Thus, reverse piercing the corporate veil allows a creditor greater access to the assets of the business entity on the other side of the veil, whereas an LLC charging order allows only a narrower remedy.

The court of appeals stated that the trial court may have been flawed in its analysis, but the appellate court considered whether the trial court was correct in its result. In so doing, the court of appeals concluded that the application of reverse veil piercing in this case was consistent with Oklahoma law. Specifically, the court concluded that Henson should be treated as the equitable owner of the two LLCs at issue, that the LLCs were his alter egos, and that they were a sham used to wrongfully protect his assets.

As for the charging order, the court of appeals explained that the trial court's order granting a charging order was superfluous in this case. "A charging order allows a judgment creditor to attach only to an LLC member's membership interest, which is personal property distinct from the LLC's assets. 18 O.S. Supp. 2017 §§ 2032, 2034. Because a reverse piercing allows a creditor to attach directly to a business association's assets, treating the business's property as the debtor's property, a charging order against the debtor's capital interest in the company is unnecessary."

### **Series LLCs**

***Reider v. Woods***, 603 S.W.3d 86 (Tex. 2020).

The Texas Supreme Court noted the statutory authority to establish series, stating: "A limited liability company may, by agreement, 'establish ... one or more designated series of members, managers, membership interests, or assets that: (1) has separate rights, powers, or duties with respect to specified property or obligations of the limited liability company or profits and losses with respect to specified property or obligations; or (2) has a separate business purpose or investment objective.' TEX. BUS. ORGS. CODE § 101.601(a)." The court did not otherwise address the particular nature or ramifications of series, focusing only on the effect of the forum selection clause at issue in the agreement creating the series in that case.

***Federal Housing Finance Agency v. Las Vegas Development Group, LLC***, No. 2:16-cv-01187-GMN-CWH, 2020 WL 1308319 (D. Nev. 2020) (holding that the court did not lack jurisdiction over properties held in the name of two series of a Nevada LLC where the plaintiff had joined the LLC as a defendant but not the series, relying on the principle that a series is not a separate entity under Nevada law and stating that a series may sue and be sued in its own name but is not a separate entity that a plaintiff must sue in its own name).

***City of Urbana v. Platinum Group Properties, LLC***, \_\_ N.E.3d \_\_, 2020 WL 1164502 (Ill. App. 2020) (describing the provisions of the Illinois LLC statute relating to the creation, nature, and

powers of series, noting that a series with limited liability is treated as a separate entity under the Illinois statute to the extent set forth in the articles of organization, and concluding that the mere assertion by a series that it was a separate entity from its “parent” LLC—without supporting documentation of a certificate of designation or citation to the relevant statutory provision—was insufficient to establish the series’ challenge to the court’s jurisdiction over the series and entry of a judgment that added the name of the series on the basis of misnomer where only the parent LLC was named as a defendant in the action; alternatively holding that the series was estopped to assert there was no misnomer).

There are numerous opinions by federal courts around the country addressing standing issues in class actions filed by MSP Recovery Claims, Series LLC, some of which touch on the nature of a Delaware series. The courts have reached varying conclusions in these cases. *See, e.g., MSP Recovery Claims, Series LLC v. Farmers Insurance Exchange*, Nos. 2:17-cv-02522-CAS (PLAx), 2:17-cv-02559-CAS (PLAx), 2018 WL 5086623 (C.D. Cal. 2018) (summarized in previous update paper and concluding that Section 18-215(c) of the Delaware Limited Liability Company Act allows an LLC to sue on behalf of its series if the limited liability company agreement permits the LLC to do so).