

**A Sampler of Recent (Non-Delaware)  
Partnership and LLC Cases**

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### Veil Piercing

*Curci Invs., LLC v. Baldwin*, 14 Cal.App.5<sup>th</sup> 214 (Cal. App. 4<sup>th</sup> Dist. 2017).

A judgment creditor of an individual sought to add the individual's LLC as a judgment debtor, i.e., to reverse pierce the veil of the LLC. The trial court held that reverse veil piercing is not available in California. The court of appeals distinguished the case relied on by the trial court and held that reverse veil piercing is available in California. Thus, the court remanded the case for a factual determination of whether the LLC's veil should be pierced.

In 2004, James Baldwin formed JPBI Investments LLC (JPBI), a Delaware LLC, for the sole purpose of "hold[ing] and invest[ing] [Baldwin and his wife's] cash balances." Baldwin and his wife were JPBI's two members, with Baldwin owning a 99% membership interest and his wife owning a 1% membership interest. Baldwin was a manager and the chief executive officer of JPBI. Baldwin thus controlled when or if JPBI made distributions to the members.

A couple years after establishing JPBI, Baldwin borrowed \$5.5 million from the predecessor of Curci Investments, LLC (Curci). Not long after that loan, Baldwin settled eight family trusts for his grandchildren with Baldwin's children as trustees. For estate planning reasons, Baldwin also established three family partnerships, the partners of which were various combinations of the family trusts. JPBI loaned more than \$42 million to the three general partnerships.

When the Curci note came due in 2009, Baldwin had made no payments, and Curci filed suit to recover the amount owed. The parties entered into a court-approved stipulation establishing a payment schedule to avoid a judgment, but Baldwin failed to make the agreed payments, and the court entered a \$7.2 million judgment against Baldwin in 2012. By 2014, no payments had been made to Baldwin on the notes from the partnerships, and Baldwin extended the due dates to 2020 for unexplained reasons and no consideration. Curci obtained charging orders against 36 entities in which Baldwin had an interest, including JPBI. Although JPBI had distributed about \$178 million to Baldwin and his wife between 2006 and 2012, no distributions had been made since the 2012 judgment on the Curci note.

In 2015, Curci filed a motion to add JPBI as a judgment debtor on the judgment against Baldwin. Curci based its motion on the doctrine of outsider reverse piercing, arguing that the doctrine should be applied to JPBI as Baldwin's alter ego because Baldwin was using JPBI to avoid paying the judgment and injustice would result if JPBI's assets could not be used to satisfy Baldwin's personal debt.

The trial court denied Curci's motion to add JPBI as a judgment debtor based on *Postal Instant Press, Inc. v. Kaswa Corp.*, 162 Cal.App.4<sup>th</sup> 1510, 77 Cal.Rptr.3d 96 (2008), in which a judgment creditor sought to add a corporation as a judgment debtor on a judgment against an individual who had been a shareholder of the corporation. In that case, the court of appeals refused to apply reverse veil piercing based on concerns about allowing judgment creditors to bypass standard collection procedures, harming innocent shareholders and corporate creditors, and using an equitable remedy where legal remedies were available. Ultimately, the court of appeals in *Curci* distinguished *Postal Instant Press* and held that reverse veil piercing of JPBI might be appropriate.

In its discussion of whether reverse veil piercing of JPBI may be applied in this case, the court of appeals first provided background and framework for its discussion of reverse piercing by reviewing basic principles associated with traditional veil piercing under the well-established alter-

ego doctrine. [Author’s Note: Although JPBI was a Delaware LLC, the court confined its discussion to California law. The court apparently did not consider the possibility that Delaware law should control the issue before the court. Even when specifically confronting the issue, California courts have not always followed the internal affairs doctrine in veil piercing cases. See *Butler v. Adoption Media, LLC*, 486 F.Supp.2d 1022 (N.D. Cal. 2007). The governing law provision of the current LLC statute that calls for application of the law of the state of formation applies to “[t]he organization of the limited liability company, its internal affairs, and the authority of its members and managers” and “[t]he liability of a member as member and a manager as manager for the debts, obligations, or other liabilities of the limited liability company.” Cal. Corp. Code § 17708.01. Thus, the provision encompasses internal affairs and traditional veil piercing but does not explicitly address reverse veil piercing.]

After reviewing the basic principles and policies associated with traditional veil piercing, the court described the two conditions that must generally be met in California to invoke the alter-ego doctrine: (1) unity of interest and ownership between the corporation and its equitable owner such that the separate existence of the corporation and shareholder do not in reality exist, and (2) an inequitable result if the acts in question are treated as those of only the corporation. Although courts list factors that may be analyzed to make an alter-ego determination, there is no “litmus test,” and each case depends on its own facts.

The court described reverse veil piercing as similar to traditional veil piercing in that both disregard the separate existence of an individual and business entity when the ends of justice require, but the doctrines differ in that reverse veil piercing seeks to satisfy the debt of an individual through the assets of the entity rather than holding an individual responsible for the acts of the entity. The court stated that a majority of jurisdictions have adopted outsider reverse piercing as an equitable remedy, and some of those jurisdictions apply the same “test” applied in traditional piercing while others include additional factors to address concerns unique to reverse piercing.

The court discussed the California appellate court’s decision in *Postal Instant Press* and concluded that it did not preclude reverse piercing in this case for several reasons. First, *Postal Instant Press* involved a corporation rather than an LLC, and the decision was expressly limited to corporations. Additionally, the facts of the instant case as well as the nature of LLCs do not present the concerns raised in *Postal Instant Press*. Here there was no “innocent” member of JPBI that could be affected by reverse piercing inasmuch as the other 1% of JPBI was owned by Baldwin’s wife, who was also liable for the debt owed to Curci because the community estate is generally liable for any debt incurred by either spouse before or during marriage. As for the concern about bypassing normal collection procedures, a creditor of an LLC member does not have the same options as a creditor of a shareholder. A shareholder’s creditor may use collection procedures that will enable it to step into the shoes of the shareholder and exercise the shareholder’s rights to vote and sell the shares, whereas an LLC member’s creditor may only obtain a charging order. The LLC member retains the rights to control and manage the LLC, including, in this case, Baldwin’s right to decide when or if distributions will be made. As for the availability of legal remedies, such as conversion and fraudulent transfer, the court acknowledged that legal remedies may be available in many cases and thereby preclude piercing, but the court stated that reverse piercing was needed to deliver justice in precisely those rare cases where legal remedies are not available. Requiring a creditor who wishes to invoke reverse piercing to demonstrate the absence of “a plain, speedy, and adequate remedy at law would protect against reverse piercing being used to bypass legal remedies.”

Baldwin argued that the California charging order statute precluded reverse piercing because the statute provides the sole remedy for creditors of an LLC member. However, the court pointed out that the statute states that the charging order is the exclusive remedy by which a judgment

creditor may “satisfy the judgment *from the judgment debtor’s transferable interest,*” whereas reverse piercing is a means of reaching the LLC’s assets, not the debtor’s transferable interest. The court also noted the comments to RULLCA—on which the California statute is based—that the charging order provisions are not intended to preclude reverse piercing where appropriate. [Again, the court did not address Delaware law, which provides in the charging order context that a creditor of an LLC member has no “right to obtain possession of, or otherwise exercise any legal or equitable remedies with respect to,” the LLC’s property. 6 Del. C. § 18-703.]

In conclusion, the court stated that the instant case may present a situation where reverse veil piercing would be appropriate, noting “Baldwin’s nonresponsiveness and claimed lack of knowledge concerning his own personal assets and the web of business entities in which he has an interest,” and his complete control over JPBI and the use of that power to extend the repayment of loans made to benefit his grandchildren and to cease making distributions to himself and his wife despite having distributed \$178 million in the six years predating the judgment.

Ultimately, the court expressed no opinion as to whether JPBI’s veil should be pierced but remanded the case to the trial court for further consideration. The court stated that there was no litmus test, as in the case of traditional veil piercing, and “the key is whether the ends of justice require disregarding the separate nature of JPBI under the circumstances,” taking into account “at minimum,...the same factors as are employed in a traditional veil piercing case, as well as whether Curci has any plain, speedy, and adequate remedy at law.”

*A.V.E.L.A., Inc. v. Estate of Marilyn Monroe, LLC*, 241 F.Supp.3d 461 (S.D.N.Y. 2017).

The court in this protracted multi-party, multi-claim, intellectual-property dispute granted summary judgment against a party that was seeking to impose liability for alleged wrongdoing of The Estate of Marilyn Monroe, LLC (a Delaware LLC that is not actually Monroe’s estate) on a related LLC based on the alter-ego theory of liability.

This dispute revolved around the rights to twelve registered trademarks involving Marilyn Monroe. In this opinion, the court addressed, inter alia, a third-party defendant’s assertion that defendant Authentic Brands Group LLC (ABG) should be held liable for alleged wrongdoing of The Estate of Marilyn Monroe, LLC (Estate LLC) on the basis that ABG was the alter ego of Estate LLC. Applying Delaware law to the veil piercing claim, the court concluded that the claimant’s allegations fell far short of alleging that Estate LLC was ABG’s alter ego.

The court looked to Delaware law to address the alter-ego argument because “New York’s choice of law rules provide that the law of the state of incorporation determines when the corporate form will be disregarded and liability will be imposed on shareholders.” The court stated that an LLC provides limited liability similar to that in the corporate form under Delaware law, and persuading a Delaware court to disregard an LLC’s corporate structure is a “difficult task.” The court stated that Delaware law permits a court to pierce an LLC’s veil where there is “fraud” or the LLC is “in fact a mere instrumentality or alter ego of its owner.” A showing that one entity is the alter ego of another requires a showing “that ‘the entities in question operated as a single economic entity,’ and (ii) that ‘there [is] an overall element of injustice or unfairness.’” The court listed a number of factors that are relevant to the “single economic entity” showing and noted that somewhat less emphasis is placed on the observance of formalities in the LLC context than in the corporate context because fewer formalities are required in the LLC context. With regard to the showing of “injustice or unfairness,” the court stated that a claimant must establish that the LLC was a “sham or shell through which the parent... perpetrates injustice.” The injustice or unfairness must result from abuse of the corporate form and must be more than merely the cause of action that is the basis of the claimant’s lawsuit.

In this case, the court found virtually no factual allegations to substantiate the alter-ego claim. The claimant alleged that the two LLCs shared senior employees, offices, and letterhead, but those facts did not speak to the factors considered under Delaware law with regard to alter ego. The claimant's allegations that Estate LLC was "'a mere corporate shell over which ABG maintains ownership' and that it 'functions as a mere facade or instrumentality for ABG'" were legal conclusions rather than factual allegations. The allegation that affording Estate LLC limited liability would promote injustice by permitting ABG to insulate itself from the wrongdoing of Estate LLC did not allege how respecting Estate LLC's form would promote injustice beyond the causes of action asserted by the claimant. Although the court recognized that an alter-ego inquiry is usually a fact-intensive process and is ordinarily a question for the jury, the court rejected the alter-ego claim in this case because the claimant's factual allegations in support of the claim were "scant and irrelevant."

*Spradlin v. Beads and Steeds Inns, LLC (In re Howland)*, 674 Fed. App'x 482 (6<sup>th</sup> Cir. 2017).

The court rejected the trustee's attempt to rely on reverse veil piercing in order to characterize a transfer of property by a non-debtor as a fraudulent transfer of the debtors' property. The court found it unnecessary to reach the question of whether the Kentucky Supreme Court would recognize reverse piercing because—even assuming Kentucky would recognize reverse piercing—the court concluded that veil piercing in Kentucky is a form of vicarious liability and not a means to consolidate two entities into one as the trustee was attempting to do.

The bankruptcy trustee sought to set aside a transfer of real property by an LLC owned by the debtors on the basis that the transfer of the property was a fraudulent transfer. Recognizing that the provisions of the Bankruptcy Code on which she relied applied to a transfer of an interest in a debtor's property, the trustee argued that she could pierce the veil of the LLC in reverse and treat the LLC and the debtors as a single entity. The bankruptcy court rejected the trustee's argument, and the district court affirmed the bankruptcy court. The trustee appealed to the Sixth Circuit.

The court of appeals stated that veil piercing falls into two camps as it relates to whether a litigant may consolidate a debtor and its alter ego into a single entity. The first camp is the "identity approach," under which a corporation and its alter ego are deemed to be a single entity such that piercing the veil "'expands the debtor's estate to include the property of its alter ego.'" However, the court found that Kentucky falls into the second camp, in which veil piercing is employed as a form of vicarious liability, based on statements by the Kentucky Supreme Court describing veil piercing as a means to impose liability on the shareholders for a debt of the corporation. The trustee argued that Kentucky would allow the use of veil piercing to consolidate entities, but the court examined the cases relied on by the trustee and concluded that they were not inconsistent with Kentucky's adherence to the vicarious liability approach to veil piercing. The court explained that "the vicarious liability approach...does not give the pierced entity (*i.e.*, the debtor) an interest in its alter ego's assets—it gives the pierced entity's *creditor* (*i.e.*, the trustee) an interest in the alter ego's assets in order to satisfy its judgment against the pierced debtor." In sum, "[b]ecause Kentucky veil piercing does not transform the alter ego's property into the property of the debtor, but rather simply allows a creditor to pursue the alter ego under a vicarious liability theory, the trustee has not stated a claim under [Bankruptcy Code] § 544 and § 548, both of which require that *the debtor* have an interest in the transferred property."

*Rocklon, LLC v. Paris*, No. 09-16-00070-CV, 2016 WL 6110911 (Tex. App. Oct. 20, 2016).

Relying on reverse veil piercing, the court held that the trial court properly enjoined an LLC from accessing, distributing, or disbursing the proceeds of the sale of the LLC's property based on evidence that the member had used the LLC as his alter ego and had fraudulently transferred the LLC's bank account to his son.

The surviving spouse and estate of Kristin Paris (collectively, "the plaintiff") brought a wrongful death suit against Rocklon, L.L.C. ("Rocklon"), Rockal, Inc. ("Rockal"), and Rockline George Kennedy, among others, after Kristin Paris died in a car accident with Kennedy. A key point of dispute in the lawsuit was Kennedy's relationship to his co-defendant entities. The plaintiff alleged that the two entities were the alter egos of Kennedy, while Kennedy alleged that he had no ownership interest in the entities.

According to the plaintiff's pleadings, Kennedy had been drinking at the bar and strip club that was operated by Rockal on real property owned by Rocklon. Kennedy then left the club in his vehicle, crossed the median of a highway and struck Kristin Paris's vehicle head on. Kennedy was arrested shortly after the incident and released a few days later. Upon his release from jail, Kennedy accompanied his son to Rocklon's bank and transferred full control of Rocklon's account to the son. Eight days after Kennedy filed his answer in the suit, Rocklon sold its primary asset, the real estate where the club was located, for approximately \$1 million. The trial court entered a temporary injunction preventing the proceeds of the real estate sale from being accessed by Rocklon, and Rocklon filed a notice of interlocutory appeal challenging the temporary injunction.

On appeal, Rocklon argued that there was no evidence that Rocklon was liable to the plaintiff on the underlying claims because the evidence did not establish that Rocklon was the alter ego of Kennedy and there was no evidence of a fraudulent transfer. In a fraudulent transfer action under the Texas Uniform Fraudulent Transfer Act (TUFTA), the statute provides that a creditor may obtain "an injunction against further disposition by the debtor or a transferee, or both, of the asset transferred or of other property." In this case, the plaintiff alleged TUFTA claims against all defendants, including Rocklon. The plaintiff alleged that Rocklon was an alter ego of Kennedy and thus a debtor under TUFTA, and that Rocklon had fraudulently transferred or was likely to fraudulently transfer its property with actual intent to hinder, delay, or defraud the plaintiff.

Turning first to Rocklon's challenge to the plaintiff's veil-piercing theory, the court noted that Texas intermediate courts of appeal and other jurisdictions have applied to LLCs the same state-law principles for piercing the veil as they have applied to corporations. Rocklon did not challenge the plaintiff's contention that veil-piercing theories are applicable to LLCs, but rather argued that the plaintiff failed to present evidence to support the plaintiff's reverse-piercing theory. The court explained that a creditor who relies on reverse veil piercing seeks to apply the alter-ego doctrine in reverse, i.e., "to hold a corporation's assets accountable for the liability of individuals who treated the corporation as their alter ego." To determine whether an alter-ego relationship exists, a court looks at the total dealings of a corporation and the individual and considers the degree to which corporate and individual property have been kept separately, the amount of financial interest, ownership, and control the individual maintains over the corporation, and whether the individual used the corporation for personal purposes. Other relevant factors include whether corporate debts were paid with personal checks or other evidence of the commingling of funds. An individual's representations that he would financially back the corporation and diversion of company profits to the individual for personal use is also evidence tending to support a finding of an alter-ego relationship. Finally, the court may also consider inadequate capitalization of the corporation. The applicable standard of review in this case was for abuse of discretion. This standard required the court of appeals to examine the evidence in the record to see if it reasonably supported the trial

court's decision. The court organized its discussion of the evidence of alter ego around three issues: (1) ownership interest and control of Rocklon; (2) commingling of funds; and (3) Kennedy's representations.

With regard to the issue of ownership and control, Rocklon argued that it was merely a real estate business that leased property to Rockal, the company that owned and operated the club, and that Rocklon was owned solely by Kennedy's son and not Kennedy. The court reviewed basic statutory concepts relating to an LLC, such as the certificate of formation, company agreement, members, membership interests, and assignees. Rocklon's certificate of formation filed with the Secretary of State on February 1, 2006, indicated that it was a member-managed LLC whose registered agent and only member was Kennedy. Two nearly identical company agreements were produced by Rocklon's bank. One version, which was unexecuted, indicated that Kennedy was the sole and initial member. The other version, which was executed, indicated that Kennedy's son was the sole and initial member. Both company agreements were dated February 1, 2006. The record also contained an assignment of membership interest in Rocklon from Kennedy to Kennedy's son dated February 1, 2006, but the court of appeals concluded that the trial court could have reasonably determined that the assignment was void due to its failure to meet the requirements of the company agreements for a valid assignment.

Both of the Rocklon company agreements contained in the record defined an assignee as "a person who receives a Transfer of all or a portion of the Membership Interest of a Member, but who has not been admitted to the Company as a Member." Another provision of the company agreement stated that "[a]ny attempted Transfer by a person of an interest or right, or any part thereof, in or in respect of the Company other than as specifically provided by this Agreement shall be, and is hereby declared, null and void ab initio." The company agreements also stated that an assignee did not have any voting right or right to participate in the operations or management of the company until admitted as a substituted member. Further, an assignee was admitted as a substituted member only when the member making the transfer granted the assignee the right to be admitted and the instrument assigning the membership interest contained an agreement by the assignee that the assignee agreed to be bound by all of the terms and provisions of the company agreement. The assignment purporting to transfer Kennedy's interest in Rocklon to his son was only signed by Kennedy and did not contain any agreement by the son as an assignee. Thus, the court concluded that the trial court could reasonably have determined the assignment failed and was void based on the provisions of Rocklon's company agreement. Further, the record contained an apparent transmittal letter from an attorney to Kennedy dated June 5, 2006, in which the attorney instructed Kennedy to execute the assignment of interest to his son and have his son execute the company agreement. When questioned in the trial, Kennedy's son stated that he was not sure when the assignment was executed and refused to confirm or deny that it was executed on February 1, 2006. Based on the conflicting documents, the court held that the trial court could properly have found that neither the assignment nor the executed version of the company agreement were reliable to show the true membership or ownership of Rocklon.

The court continued its review of the documents in the record by looking at franchise tax and bank records, finding that they too were inconclusive as to ownership of Rocklon. In the franchise tax reports for 2010, 2012, and 2013, Kennedy was identified as the only officer, director, or member of Rocklon. Although the Tax Code does not require all members to be listed, the court found that the documents, interpreted reasonably, could lead to the conclusion that Kennedy was at least the managing member of Rocklon. The court of appeals described the testimony of Kennedy's son as conflicting with the documents relating to Rocklon's formation in that Kennedy's son testified that he was the owner from the very beginning and that his father's only role was in guaranteeing the real



estate loan to Rocklon to purchase its property. On appeal, Rocklon acknowledged that Kennedy was identified as the initial member in the certificate of formation, but argued that Kennedy's son executed the company agreement as its sole member and accepted an assignment of his father's membership interest. Given the conflicting evidence, the court of appeals said that the trial court could have discredited the son's testimony.

Bank records also supported the contention that Kennedy was the sole member of Rocklon and had sole control of its bank account. Kennedy's signature was the only signature on the signature card, he was identified as president of Rocklon, and his personal address was listed as the address of the company. Also, in June of 2006, after the purported transfer to his son, Kennedy applied for a real estate loan on behalf of Rocklon, and the loan worksheet identified Kennedy as a member of Rocklon. Kennedy pledged his personal life insurance policy to secure the loan. Despite these records, the bank records relating to this loan also contained a resolution signed by Kennedy's son in which he represented that he was the sole member of Rocklon. Kennedy's son testified that his father was only the "land manager" of Rocklon.

Before reaching its ultimate conclusion on the issue of ownership and control, the court also mentioned Rocklon's income tax return forms for two years (which were signed by Kennedy's son as the sole "stockholder"), statements of emergency personnel at the scene of the car accident (reporting that Kennedy represented that he owned the bar and strip club), and statements of employees of the club (who were uncertain about the ownership of the club but described involvement by Kennedy in its operations). After noting that alternative conclusions could be drawn from the evidence, the court ultimately concluded that the record contained some evidence to show that Kennedy had full, seemingly unchecked control over every aspect of Rocklon's business until shortly after his release from jail.

The court next discussed evidence of commingling of funds of Kennedy, Rockal, and Rocklon. Under its lease of the premises from Rocklon, Rockal was to pay monthly rent to Rocklon as well as real estate taxes. However, evidence showed that Kennedy used Rocklon's assets to pay the real estate taxes and that Rocklon received substantially less than it was entitled to receive in rent payments. Additionally, there was evidence that Kennedy wrote checks from Rocklon's account for his personal benefit. This commingling led the court to conclude that "[g]iven all the evidence, the trial court could have found that Kennedy was at the heart of both of these entities and that he commingled funds from Rocklon, Rockal, and his personal account in disregard of the corporate fictions."

Finally, the court of appeals noted that Kennedy personally represented to the bank that he was a member of Rocklon, and he guaranteed its loan. He took out a life insurance policy to support his representations to the bank. The court stated that the trial court could have reasonably considered this as some evidence of Kennedy's use of the corporate fiction as his alter ego.

Based on all of the evidence before the trial court concerning Kennedy's total dealings with Rocklon, and viewing the evidence in a light most favorable to the trial court's finding, the court of appeals concluded that the evidence reasonably supported a probable right of recovery at trial based on an alter-ego relationship between Kennedy and Rocklon.

The court then turned its attention to whether Kennedy's transfer of Rocklon's bank account to his son was a fraudulent transfer. Based on the evidence that Rocklon was the alter ego of Kennedy, the court stated that it could consider a transfer by Rocklon as a transfer by Kennedy. After Kennedy was released from jail he passed control of Rocklon's account to his son. Further, Kennedy and his son executed corporate resolutions authorizing the son to communicate with the bank regarding payoff of the loan on the property and to pay off the promissory note to the bank, thus allowing the son to sell the real estate owned by Rocklon. This resolution also gave the son authority

to transfer any proceeds from Rocklon's bank account. The court found this evidence was sufficient to be a transfer of an asset under TUFTA.

The court then examined whether "badges of fraud" were present in the transfer. The facts the court found persuasive were that the transfer was to Kennedy's son, an insider, that the real estate was substantially all of the assets of Rocklon, that there was some evidence that Kennedy tried to conceal the transfer by going to an out-of-town branch of the bank, that Kennedy received no value in return for the transfer, and finally that the transfer was only made after Kennedy had been charged with intoxication manslaughter and could have known that the civil lawsuit was likely imminent.

The last TUFTA requirement of imminent and irreparable harm was satisfied by evidence that following the sale of the real estate, Kennedy's son had begun writing checks to himself out of the Rocklon account. The court agreed with the plaintiff that should the temporary injunction not be in place, the proceeds of the sale of Rocklon's asset could be gone before completion of a trial. The court thus held that the temporary injunction was properly granted and affirmed the order of the trial court.

### **Personal Liability of Member or Manager for Member's or Manager's Own Acts Under Other Law**

*State v. Morello*, \_\_\_ S.W.3d \_\_\_, 2018 WL 1025685 (Tex. 2018).

The State of Texas sued an individual member/manager of an LLC for violations of the Texas Water Code based on the individual's role in the LLC's failure to satisfy the compliance plan accompanying the LLC's hazardous waste permit. The court of appeals relied on the liability protection provided to members and managers of LLCs under the Texas LLC statute and concluded that the State had not shown that the alleged failures to satisfy the compliance plan constituted the type of "tortious or fraudulent" acts for which corporate officers can be held personally liable when they participate in or perform such acts as agents of a corporation. The supreme court acknowledged the liability protection provided to members and managers of LLCs under the Texas LLC statute but stated that the individual was personally liable based on the language of the Texas Water Code and the individual's own actions, which subjected the individual to liability regardless of whether the individual was acting as an agent of the LLC.

Bernard Morello formed White Lion, L.L.C. ("White Lion") to purchase property out of a bankruptcy estate. When White Lion purchased the property, a hazardous-waste permit and compliance plan associated with the property were transferred to White Lion. A few years later, the State of Texas sued White Lion alleging that White Lion did not meet the requirements of the compliance plan. The State subsequently amended its petition and sued Morello individually as well as White Lion. After the trial court granted the State's motion for summary judgment against White Lion and severed the claims against Morello, the State moved for summary judgment against Morello. The State alleged that Morello was the sole decision maker for White Lion and was personally and substantially involved in operating, managing, and making decisions concerning White Lion's facility. The State also asserted that Morello personally removed and disposed of water-treatment systems and equipment. Morello's actions, the State asserted, violated Water Code § 7.101, which provides that it is a violation of the Water Code for a "person" to "cause, suffer, allow, or permit a violation of a statute within the commission's jurisdiction or a rule adopted or an order or permit issued under such a statute." The trial court granted the State's motion for summary judgment and ordered Morello to pay \$367,250 in civil penalties.

Morello appealed the trial court's judgment, arguing that he could not be held individually liable because the State was not attempting to pierce the veil of the LLC and did not allege the type

of conduct for which an agent of an LLC may be held individually liable when acting on behalf of the company. The court of appeals recognized that the formation of an LLC is intended to shield members from the company's liabilities and obligations, but also acknowledged the common-law principle that a corporate officer may be held individually liable when the officer "knowingly participates in tortious or fraudulent acts" even though the officer performed the acts as an agent of the corporation. The court of appeals concluded that the State had not shown that the alleged failures to comply with the compliance plan constituted "tortious or fraudulent conduct of Morello individually or that those failures to comply should somehow be treated as if they were." The State appealed.

The Texas Supreme Court explained that Morello's claim that he could not be held personally liable was premised on the liability protection provided members and managers of LLCs under the Texas Business Organizations Code, but the State relied on application of the Texas Water Code directly to Morello because of his own actions, not because of the LLC's liability. The court examined the plain language of Section 7.01 of the Water Code, which provides that "[a] person may not cause, suffer, allow, or permit a violation of a statute within the commission's jurisdiction or a rule adopted or an order or permit issued under such a statute." Section 7.02 provides that [a] person who causes, suffers, allows, or permits a violation of a statute, rule, order, or permit relating to any other matter within the commission's jurisdiction to enforce ... shall be assessed" a civil penalty. Morello argued that he was not a "person" within the meaning of Section 7.02, but the court determined that the plain meaning of "person," which is not defined in Chapter 7 of the Water Code, includes an individual in the absence of a definition excluding an individual.

Morello argued that he never assumed or was transferred any obligations under the permit, but the court said nothing in the language of the Water Code limits the number of persons to whom its penalties apply. The plain language of the statute permitted assessment of a penalty against Morello if he was "a" person who caused or allowed violation of the permit; he did not have to be "the" person holding the permit. Thus, the State could assess a penalty against him regardless of whether White Lion or others were also subject to penalties arising from violations and regardless of who had obligations under the permit.

The Austin Court of Appeals had agreed with Morello that he could not be individually liable because his acts as an agent of White Lion were not the type of "tortious" or "fraudulent" acts for which agents can be held personally liable when acting in their agency capacity. The court of appeals distinguished or disagreed with other cases in which employees or officers had been held personally liable for statutory violations based on acts taken in their representative capacity. According to the court of appeals, statutory violations must be in the nature of "fraudulent" or "tortious" conduct in order to hold an individual liable for actions taken in a representative capacity. The Texas Supreme Court rejected this distinction and stated that the analysis in the other cases focused on whether the individual could be liable under the language of the statute and whether the individual personally engaged in the conduct constituting the violation. For example, the supreme court pointed to a case in which it held that a corporate agent acting in the scope of his employment could be held personally liable for violations of the Texas Deceptive Trade Practices Act (DTPA). Based on the plain language of the DTPA—which permits a claim against "any person"—the court held that a sales agent of a homebuilder was personally liable for DTPA violations based on misrepresentations made by the agent. The court also pointed to two cases in which a Texas appellate court interpreted the Water Code as providing for liability of individual agents for their own actions, and the court stated that "federal and state courts have consistently rejected the position that where an environmental statute applies to a 'person,' corporate officers can avoid individual liability for violating the statute if they personally participated in the wrongful conduct." Although the federal

and state cases cited by the court did not involve the provision of the Water Code at issue in this case, the court said that the cases were consistent with the court's view that an individual is not protected by the corporate shield when an environmental regulation applies to a "person" and the individual personally participates in conduct that violates a statute. In sum, Morello was not held liable for an obligation or liability of White Lion (which he asserted is prohibited by the Texas Business Organizations Code) but was held liable based on his individual, personal actions.

The supreme court also rejected Morello's argument that the severance of the claims against him from the claims against White Lion resulted in two judgments based on identical theories of liability and facts and violated his constitutional rights to equal protection and due course of law by imposing excessive fines leading to a double recovery for the State. The court stated that the trial court's severance of the cases was not improper since they were two causes of action that could have been brought separately. Further, although the cases were factually intertwined, the State's case against Morello involved evidence of his personal actions (such as Morello's removal and disposal of certain systems and equipment) that was not presented in the case against White Lion. Thus, the trial court did not abuse its discretion in severing the claims against White Lion from the claims against Morello. The court also explained that the severance of the claims did not result in a double recovery for the State because the civil penalties do not reimburse the State for loss or damage but are instead penalties against Morello and White Lion. The civil penalties "are not recoveries designed to make the State whole for damages it suffered and undertook to prove, much less are they two separate recoveries for the same damages the State suffered. Thus, the civil penalties assessed against Morello are constitutional."

### **Admission of Member**

*Johnson v. Crossett*, 408 P.3d 1272 (Idaho 2018).

Two men orally agreed to form an LLC in which one of them would take an active role as the manager and the other would not take part in the day-to-day business. The men also agreed to recruit an employee from a competing business with a view towards later admitting her as a member. The individual who agreed to manage the LLC recruited the employee and formed the LLC. After a written operating agreement was prepared with terms satisfactory to the parties, the inactive individual refused to sign the written operating agreement. Initially, the refusal was based on his desire to keep his role in the business a secret, but later the refusal was based on financial difficulties of the LLC. The individual who formed the LLC operated it for a period of time and eventually agreed to sell all the LLC's assets to another company after the LLC's financial difficulties continued. The purchasing company acquired the LLC's assets in exchange for assumption of the LLC's debts, which greatly exceeded the LLC's assets. The inactive individual and the employee of the LLC filed suit alleging that they were members of the LLC since its inception and that they were improperly expelled. The trial court concluded that the plaintiffs never became members of the LLC, interpreting the oral agreement between the two men to require that the plaintiffs sign the written operating agreement to become members. The Idaho Supreme Court affirmed.

Johnson and Crossett agreed to form an LLC to operate a business similar to a business Johnson's brother-in-law ("Brother-In-Law") had started. Under the oral agreement reached by Johnson and Crossett (the "Oral Agreement"), Crossett would be the sole agent and manager, receive a fixed salary, and own a 46% interest. Johnson would not be involved in day-to-day operations or receive compensation but would own a 44% interest. The two men also agreed that Crossett would contact Cousins, an employee of Brother-In-Law's company, to recruit her to work for their

company. Cousins was hired in May 2013 and was to receive a 10% interest in the company at some point, but she was not a party to the Oral Agreement.

Crossett filed a certificate of organization to form the company as a single-member LLC in June 2013. By the end of July 2013, a written operating agreement (“Written Agreement”) was prepared and approved by Crossett and Johnson, but the agreement was never signed. The LLC opened for business in July 2013 and was sued by Brother-In-Law’s company. Johnson refused to sign the Written Agreement because he did not want Brother-In-Law or other members of his family to know he was associated with the LLC. The LLC’s business grew quickly and ran into cash flow problems, bad publicity from Brother-In-Law’s lawsuit, and large legal fees from defending the lawsuit. Cousins resigned in October 2014 and was paid all the money she was owed.

Late in 2014, Crossett insisted that Johnson sign the Written Agreement and join him in personally guaranteeing some of the legal fees owed the LLC’s attorneys. Johnson refused and stated that these problems must be solved by Crossett. Johnson said he would not sign until the problems were resolved. Johnson and Crossett did not come to terms, and Crossett continued to operate the LLC as a single-member LLC. Johnson was eventually repaid what he invested in the LLC, but the LLC continued to have financial difficulties. Crossett outsourced the LLC’s business to a new LLC he formed with another individual, and eventually Crossett agreed to sell the LLC’s assets to the new company in exchange for the new company’s assumption of the LLC’s debts, which far exceeded the value of the LLC’s assets.

After a two-day bench trial, the trial court found that the Oral Agreement served as an operating agreement for the LLC in that it was an agreement to operate the LLC until the Written Agreement was ready to be signed. Specifically, the district court found that the Oral Agreement provided that Johnson and Cousins would only become members once they signed the Written Agreement. The trial court also concluded that Crossett did not breach any fiduciary duties (because the plaintiffs were not members and were paid what they were owed) and was not liable for money he withdrew from the LLC (because the withdrawals did not exceed what he was owed for his managerial duties).

On appeal, the plaintiffs first contended that Crossett’s admission to a particular allegation in the complaint precluded the trial court from finding that Crossett formed a single-member LLC. The court characterized the plaintiffs’ reliance on the admission as “flimsy” and rejected the contention that the admission demonstrated that the trial court’s finding was clearly erroneous. The court acknowledged that Crossett could have been more specific in clarifying his response to one part of the allegation (in which he was referred to as “a” member rather than “the” member), but the lack of specificity did not render the trial court’s finding clearly erroneous.

The court next rejected the plaintiffs’ contention that the trial court erred in interpreting or applying the Idaho Uniform Limited Liability Company Act (the “LLC Act”) by allowing the unsigned Written Agreement to undercut the parties’ Oral Agreement. The plaintiffs argued that the trial court ignored the provision of the LLC Act that provided an operating agreement may be oral. The court stated that the plaintiffs took certain statements by the trial court out of context and that the trial court did not hold that an oral operating agreement may be undermined by the mere drafting of a written agreement. The court said the trial court “made clear that it was not the mere drafting of the Written Agreement, in the abstract, that undermined the Oral Agreement; rather, per the Oral Agreement, once the Written Agreement was ready to be signed, Appellants could only become members by signing.”

Finally, the court held that the trial court did not err by awarding attorney’s fees to Crossett under an Idaho statute that allows a prevailing party to recover attorney’s fees when the gravamen of the lawsuit is a commercial transaction. The court cited a case in which members of an LLC

brought individual and derivative claims against the founder of the LLC, and the court affirmed an award of attorney's fees on the individual claims pursuant to the statute regarding a commercial transaction and an award of attorney's fees on the derivative claims pursuant to the LLC Act. The court distinguished cases in the partnership and corporate context where attorney's fees were not recoverable because the gravamen of the actions related to enforcement of statutory provisions. Although the LLC Act was related to this action, the court said the gravamen of the action was a dispute over a claimed breach of contract, i.e., the Oral Agreement, which was a commercial transaction.

*Estate of Calderwood v. ACE Grp. Int'l, LLC*, 157 A.D.3d 190, 67 N.Y.S.3d 589 (App. Div. 1<sup>st</sup> Dept. 2017).

The court held that the rights of the estate of a deceased member of a Delaware LLC were limited by the LLC agreement to the rights of an assignee notwithstanding Section 18-705 of the Delaware Limited Liability Company Act, which provides that a deceased member's personal representative may exercise all of the rights of the member for the purpose of settling the member's estate or administering the member's property.

Alex Calderwood formed an LLC with Ecoplace LLC ("Ecoplace"), an LLC controlled by Stefanos Economu. Calderwood died unexpectedly. At the time of his death, Calderwood held a majority stake in the LLC, which Ecoplace offered to purchase. The estate refused the offer and sued the LLC, Ecoplace, and Economu asserting numerous causes of action. The motion court dismissed several of the estate's claims, and the estate appealed.

First, the appellate court addressed the motion court's dismissal of the estate's claim for a declaration that the estate was a member of the LLC with all of Calderwood's rights. The defendants relied on the LLC agreement, but the estate argued that the Delaware LLC statute conferred the estate with all of Calderwood's rights notwithstanding the LLC agreement.

Section 9.7(b) of the LLC agreement provided:

Upon the death or disability of a Member ... (the "Withdrawing Member"), the Withdrawing Member shall cease to be a Member of the Company and the other Members and the Board shall ... have the right to treat such successor(s)-in-interest as assignee(s) of the Interest of the Withdrawing Member, with only such rights of an assignee of a limited liability company interest under the Act as are consistent with the other terms and provisions of this Agreement and with no other rights under this Agreement. Without limiting the generality of the foregoing, the successor(s)-in-interest of the Withdrawing Member shall only have the rights to Distributions provided in Sections 4 and 10.3, unless otherwise waived by the other Members in their sole discretion.

Section 18-705 of the Delaware LLC Act states:

If a member who is an individual dies ... the member's personal representative may exercise all of the member's rights for the purpose of settling the member's estate or administering the member's property, including any power under a limited liability company agreement of an assignee to become a member.

The estate argued that the statutory provision permitted the estate to exercise all of Calderwood's rights notwithstanding the limitations in the LLC agreement, but the court responded

by recognizing that the parties to an LLC agreement have substantial latitude to shape their own affairs and that the primary function of the statute is to fill gaps in the LLC agreement. The estate argued that Section 18-705 controlled over the LLC agreement because Section 18-705 does not contain the proviso “unless otherwise provided in the limited liability company agreement,” but the court rejected that argument on the basis of Delaware case law finding that another provision of the LLC statute lacking such a proviso was nonetheless permissive and subject to modification. The court also found it notable that Section 18-705 contains the phrase “may exercise,” which Delaware case law has stated indicates a “voluntary, not mandatory or exclusive, set of options.” The court also rejected the estate’s argument that the policy of protecting vulnerable heirs supported the conclusion that Section 18-705 is mandatory under Delaware law. The court quoted Delaware case law stressing the primacy of contract in the LLC context and concluded: “[W]hether section 18-705 is mandatory or permissive, we, nonetheless, find that in this case it does not override section 9.7(b) of the LLC Agreement.”

The court next rejected the estate’s contention that the LLC agreement did not unambiguously abrogate Section 18-705 of the Delaware LLC Act. First, the court noted that any conflict between the LLC agreement and the statute should be resolved in favor of the LLC agreement. Second, the court concluded that the LLC agreement was not susceptible to different interpretations, but clearly stated the consequences of the death of a member.

The estate also argued that a determination that the estate was not a member of the LLC would lead to an absurd result because the majority owner would have no participation or control rights while the minority owner would have full control. The court did not view such a result as absurd, pointing to Delaware case law recognizing the distinction between tolerating a new passive co-investor that one did not choose and enduring a new co-manager without consent.

***Stanfield v. On Target Consulting, LLC***, 90 N.E.3d 962 (Ohio App. 2017).

An individual’s tax returns showing income from an LLC and filings made by the LLC with the Ohio Division of Liquor Control naming the individual as “owner,” “manager,” and “partner” of the LLC were not “records of the limited liability company” for purposes of determining that the individual was a member. When determining whether a person is a member of an LLC, a court must consider records that are maintained by the LLC for the purpose of its corporate governance and that name owners entitled to receive distributions and share in profits and losses of the LLC.

A judgment creditor obtained charging orders against the judgment debtor’s alleged interests in three LLCs. Although the operating agreements of the LLCs did not list the judgment debtor as a member, the tax returns of the judgment debtor showed income from the three LLCs, and documents filed by the LLCs with the Ohio Department of Commerce–Division of Liquor Control listed the judgment debtor alternately as “owner,” “manager,” and “partner.” On appeal, the judgment debtor argued that the operating agreements established that he was not a member and that the trial court erred in granting the charging orders.

The Ohio LLC statute permits a judgment creditor of a member to apply for an order charging the membership interest of the member, and the statute defines a “member” as “a person whose name appears on the records of the limited liability company as the owner of a membership interest in that company.” Ohio Rev. Code § 1705.01(G). A “membership interest” is “a member’s share of the profits and losses of a limited liability company and the right to receive distributions from that company.” Ohio Rev. Code § 1705.01(H). The judgment debtor argued that the operating agreements conclusively established that he was not a member of the LLCs, but the judgment creditor argued that the records from the Division of Liquor Control were “records of the limited liability company” because the statute does not define the phrase or limit such records to the operating agreement. The

judgment creditor argued that “records of the limited liability company” should include any document that “records or documents past events” of the LLC—in essence, any document generated by the LLC in the normal course of business.

The court rejected the judgment creditor’s proposed definition of “records of the limited liability company” as unworkably broad and found it instructive to look at the statutory provision listing the records required to be kept by an LLC at its principal office. The court said that all of the listed records are required to be maintained for purposes of the LLC’s corporate governance. According to the court, limiting “records of the limited liability company” to documents involving corporate governance that establish a membership interest in an LLC is consistent with the statutory record keeping requirement, provides the most reliable information regarding the LLC’s structure and operation, and guides the trial court as to what records to examine to determine whose name appears as an owner “entitled to receive distributions and share in the profits and losses.” Thus, to determine who is a member of an LLC for purposes of issuance of a charging order, a court must consider records that are maintained by the LLC for the purpose of its corporate governance and that name those owners entitled to receive distributions and share in the profits and losses of the company.

Based on the definition of “records of the limited liability company” adopted by the court, the judgment creditor failed to produce evidence that the judgment debtor was a member of any of the three LLCs at issue. The filings with the Division of Liquor Control were documents relating to the LLC’s business operation, not its corporate governance, and the judgment debtor’s tax returns were not documents of any of the three LLCs. The only “records” of the three LLCs before the trial court were the operating agreements, which showed that the judgment debtor was not a member of any of the three LLCs. The trial court thus erred when it granted the motion for the charging orders.

### **Fiduciary Duties**

*Estate of Calderwood v. ACE Grp. Int’l, LLC*, 157 A.D.3d 190, 67 N.Y.S.3d 589 (App. Div. 1<sup>st</sup> Dept. 2017).

The court held that the rights of the estate of a deceased member of a Delaware LLC were limited by the LLC agreement to the rights of an assignee notwithstanding Section 18-705 of the Delaware Limited Liability Company Act, which provides that a deceased member’s personal representative may exercise all of the rights of the member for the purpose of settling the member’s estate or administering the member’s property. The court also held that the estate was not owed fiduciary duties by the managing member of the LLC.

Alex Calderwood formed an LLC with Ecoplace LLC (“Ecoplace”), an LLC controlled by Stefanos Economu. Calderwood died unexpectedly. At the time of his death, Calderwood held a majority stake in the LLC, which Ecoplace offered to purchase. The estate refused the offer and sued the LLC, Ecoplace, and Economu asserting numerous causes of action. The motion court dismissed several of the estate’s claims, and the estate appealed.

The appellate court first rejected the estate’s argument that it was a member of the LLC, concluding that the estate had only the rights provided by the LLC agreement, which limited the estate’s rights to those of an assignee. The court next concluded that the estate’s claim for a declaration that it was owed fiduciary duties by the managing member was based on a “strained interpretation” of Delaware law and was properly dismissed by the motion court. The estate characterized itself as a party bound by the LLC agreement and argued that Ecoplace, as a managing member of the LLC, and Economu, who controlled Ecoplace, owed the estate fiduciary duties. (In a footnote, the court noted that the estate did not, and could not, argue that the LLC owed it a



fiduciary duty because an LLC does not owe a fiduciary duty to a member and thus does not owe a duty to a non-member.) The estate relied on *Feeley v. NHAOCG, LLC*, 62 A.3d 649, 661 (Del. Ch. 2012) and Sections 18-1101 and 18-1104 of the Delaware LLC Act for the proposition that LLC managers owe fiduciary duties to others bound by the LLC agreement unless the duties are expressly disclaimed. The court stated that the estate's pronouncement that it was a party bound by the LLC agreement and its reliance on "default" fiduciary duties were unfounded. The court said the *Feeley* court did not explain what is meant by "otherwise bound by a limited liability company agreement" in Section 18-1101(c). The court said the case law considering the term has arisen in the context of creditors of the LLC rather than a successor-in-interest, and the court also stated that the Delaware Supreme Court has called into question whether the Delaware LLC Act imposes "default" fiduciary duties, citing *Gatz Properties, LLC v. Auriga Capital Corp.*, 59 A.3d 1206, 1219 (Del. 2012). (The court did not discuss the amendment of Section 18-1104 after the *Gatz* case to provide that "the rules of law and equity relating to fiduciary duties ... shall govern.") The court pointed out that the court in *Feeley* was dealing with a dispute between a managing-member and a nonmanaging-member and did not address if or when fiduciary duties are owed by a member to a nonmember. The court stated that its decision did not impact causes of action asserted by the estate in its amended complaint for breach of contract based on the duty of good faith and fair dealing related to its rights to distributions and its alleged right to call Ecoplace's interest.

The court stated that the estate's claims for constructive trust and an accounting were governed by New York law. The court held that the claim for an accounting was properly dismissed because the estate was not owed fiduciary duties by the defendants, and the claim for constructive trust was properly dismissed because the estate did not show that the defendants held any interest or property obtained through unjust enrichment.

Finally, the estate had no right to inspect the LLC's books and records because it was not a member of the LLC.

***Miller v. FiberLight, LLC***, 808 S.E.2d 75 (Ga. App. 2017).

A minority member of a Delaware LLC sued the majority members and chair of the board for breach of fiduciary duty and breach of the implied covenant of good faith and fair dealing in connection with amendments to the operating agreement, termination of his employment and redemption of his interest, and rejection of offers to purchase the company. Although the court rejected the defendants' argument that provisions of the LLC agreement eliminated fiduciary duties, the court affirmed the trial court's summary judgment that the defendants did not breach any default fiduciary duties in connection with the amendments or the termination of the plaintiff's employment and redemption of his interest. At the time of the first amendment of which the plaintiff complained, the defendants were not yet majority members owing any fiduciary duties. The subsequent actions taken by the defendants when they owed fiduciary duties were expressly allowed by the LLC agreement as previously amended, so there was no breach of fiduciary duty or breach of the implied covenant of good faith and fair dealing. As for the plaintiff's claim relating to the rejection of purchase offers for the LLC, there was a dispute as to whether any purchase offers were received; therefore, summary judgment was not appropriate on that claim.

Miller and several other parties entered into an operating agreement for a Delaware LLC, and the agreement was amended on multiple occasions. Miller complained that he was coerced by economic duress (threats of termination) to agree to the third, fourth, and fifth amended and restated operating agreements. The amended operating agreements enabled the defendants to reduce his interest and redeem it when he eventually was terminated.

Miller relied on default fiduciary duties under Delaware law in asserting his breach-of-fiduciary-duty claims. The defendants argued that fiduciary duties were eliminated by provisions of the operating agreement, but the court held that none of the provisions relied upon by the defendants explicitly eliminated fiduciary duties. In support of the defendants' claim that the default duty of care was eliminated, the defendants relied on exculpation provisions of the operating agreements that provided there would be no right, claim, or cause of action against any director or member for acting or failing to act in accordance with the director's or member's rights or obligations under the operating agreement. In support of their contention that the default duty of loyalty was eliminated, the defendants' relied on a provision of the operating agreement allowing members to participate in other business opportunities and compete with the LLC. The defendants also argued that the entire-agreement clause eliminated default fiduciary duties. The court rejected the defendants' arguments and stated that none of the provisions relied upon by the defendants plainly, unambiguously, or explicitly eliminated default fiduciary duties. Thus, default fiduciary duties applied to the decisions challenged by Miller in this case. The court went on to conclude, however, that most of Miller's claims for breach of fiduciary duty failed.

The third amended agreement made many changes, including converting more than \$10 million in debt owed to the LLC's largest creditors into equity, thereby making the creditors the majority members of the LLC. The amendments also added a provision requiring redemption of an individual member's interest on termination of the individual's employment as well as provisions changing the structure and voting of the board so that appointees of the new majority members would have unilateral authority to take action, including amendment of the LLC agreement (which previously required unanimous consent of the members). Miller claimed that the defendants breached fiduciary duties to him by coercing him to sign the third amended operating agreement by threats of termination, but this claim failed because the defendants were not majority members when Miller signed the third amended agreement and thus owed him no fiduciary duties at the time. Furthermore, the defendants did not have the authority to terminate Miller at that time.

The court next addressed Miller's claim that the fourth and fifth amended agreements, pursuant to which his interest was diminished, should be disregarded because his consent to those agreements was coerced. The court held that the failure of Miller's claim as to the third amended agreement defeated his claims that the defendants breached their fiduciary duties by enforcing the fourth and fifth amended agreements because the third amended agreement gave the majority members the unilateral right to enact the fourth and fifth agreements regardless of whether Miller consented. The court said that it had found no Delaware authority to support the proposition that a party breaches a fiduciary duty by taking action specifically authorized under an LLC agreement. The court said Delaware law was clear that provisions in an LLC's operating agreement supersede default fiduciary duties.

The court also rejected Miller's claim that the defendants breached default fiduciary duties by redeeming his interest in the LLC upon his termination, again relying on the proposition that a party who takes action specifically authorized under an LLC agreement does not breach a default fiduciary duty.

Miller argued that whether the defendants breached their fiduciary duties to him by rejecting offers to purchase the LLC depended on disputed issues of fact, and the appellate court agreed with Miller on this point. The defendants asserted, and the trial court found, that the LLC never received any offers, but there was conflicting testimony on this point. Thus, the appellate court found that whether the defendants breached default fiduciary duties by rejecting offers to purchase the LLC depended on disputed issues of material fact.

Miller next argued that the trial court erred in granting the defendants summary judgment on his claim for breach of the implied covenant of good faith and fair dealing. The trial court ruled that there was no breach because the agreements allowed the defendants to terminate Miller and redeem his membership interests. Miller argued that he should be allowed to pursue this claim regardless of whether the agreements allowed redemption of his membership interests because the covenant protects reasonable expectations, and he expected and was given reassurance that he would receive a substantial return on his investment in LLC. The court rejected this argument on the basis that the implied covenant cannot be used to override express provisions of a contract. Miller also argued that his claim for breach of the implied covenant was supported by a provision of the agreement stating that removal of an officer did not affect the rights of the officer as a member, but the court stated that the specific language in a contract controls over the general, and the agreement specifically allowed redemption of Miller's interest.

*CBIF Ltd. P'ship v. TGI Friday's Inc.*, No. 05–15–00157–CV, 2017 WL 1455407 (Tex. App. Apr. 21, 2017).

The court of appeals held that the evidence supported the jury's findings that an entity that was a partner in a joint venture and a controlling limited partner in a limited partnership breached its fiduciary duties to the joint venture, the limited partnership, and the other partners notwithstanding that the actions taken were within the contractual rights provided by the joint venture agreement and limited partnership agreement because "contractual rights must be exercised in a manner consistent with fiduciary duties" when the two overlap. The court also discussed the contours of a cause of action for knowing participation in a breach of fiduciary duty and concluded that the evidence supported the jury's findings that an individual knowingly participated in breaches of fiduciary duty by entities he controlled.

In 1995, TGI Friday's submitted a bid for a concession space at DFW Airport. The bid proposed a joint venture in which disadvantaged business enterprise (DBE) partners would have 35% ownership interest, as was required by government regulations. After DFW approved the proposal, Friday's formed TGIF/DFW Restaurant Joint Venture (TGIFJV) with three other partners—two DBE partners and a corporation owned by Steve Flory, which ultimately assigned its interest to CBIF Limited Partnership (CBIF), another entity controlled by Flory. Each of the four partners was required to make a capital contribution of \$1.55 million in exchange for a 25% ownership interest in TGIFJV. Both of the original DBE partners had trouble making their required capital contributions. The interest of one of these DBE partners was acquired by a newly formed limited partnership, TSQF Limited Partnership (TSQF). TSQF's limited partners were CBIF and three individuals (the RSH Group) who comprised the ownership group of the defaulting DBE partner whose interest TSQF acquired. The general partner of TSQF was Texas Star Quality Foods, LLC (Texas Star). Texas Star was managed by Columbia Airport LLC (Columbia), owned by Flory and one of the members of the RSH Group. The RSH Group owned 51% of TSQF, but TSQF was structured so that the RSH Group could not cause TSQF to act without Flory's consent. The interest of the other original DBE partner was acquired by Friday's and CBIF. As a result, TSQF, with a 25% interest, became the only remaining DBE partner in TGIFJV, but the agreement between Friday's and DFW Airport required DBE partners to own 35% of the joint venture. Flory refused to allow CBIF to sell 5% out of its 37.5% interest to help make up for the 10% difference. Therefore, Friday's sold 10% out of its 37.5% interest to Domain Enterprises, Inc. (Domain), a DBE. Ultimately, TGIFJV had four partners—LBD Corporation, a subsidiary of Friday's, with 27.5%; CBIF, controlled by Flory, with 37.5%; Domain with 10%; and TSQF Limited Partnership, owned by the RSH Group, CBIF, and Texas Star, with 25%.

In 1996, TGIFJV entered into a lease agreement with DFW Airport for an initial term of 10 years with two renewal options of 5 years. In 2004, DFW Airport accepted bidding for concession spaces with the requirement that a DBE own 35% interest. Flory failed to meet capital contributions on time and changed his mind multiple times as to whether he wanted to move forward with another lease. This flip-flopping left TSQF with only 25%, rather than the 40% the RSH Group wanted to acquire.

In 2009, DFW Airport began to renovate the airport and required restaurants to enter a new lease. Under new federal requirements, a DBE not only had to own a certain percentage of the venture but also maintain a degree of control at both the DBE partner level and the joint venture level. After a review, DFW Airport and the FAA found TGIFJV's agreement failed to comply with these new control requirements. Friday's and the RSH Group proposed amendments to the joint venture agreement that would give the DBE partners, Domain and TSQF, greater control, but Flory refused to agree to the changes. Ultimately, Friday's and the RSH Group created a new joint venture and secured the lease. Friday's and RSH Group entered a side agreement with Domain and CBIF to maintain their interests.

In 2011, Friday's sued CBIF, Columbia, and Flory (the CBIF parties). The CBIF parties filed crossclaims against Friday's and third-party claims against TSQF, the RSH Group, and others. TSQF and the RSH Group asserted claims against the CBIF parties. On appeal, the CBIF parties appealed a judgment in favor of the other parties on claims including judicial dissolution of TGIFJV and breach of fiduciary duty.

The court of appeals found that there was sufficient evidence to support the jury's finding that CBIF breached its fiduciary duty to Friday's by unreasonably withholding consent to a new lease with DFW Airport and acting in its own self-interest. CBIF argued it could not be held liable for breach of fiduciary duty because it was merely exercising its contractual right to vote against proposed changes to the venture's governing documents. The court of appeals rejected this argument, stating that contracts "do not exist in a vacuum" and that "contractual rights, such as those claimed by CBIF, do not 'operate to the exclusion of fiduciary duties.'" Where contractual rights and fiduciary duties "overlap, contractual rights must be exercised in a manner consistent with fiduciary duties." The joint venture agreement of TGIFJV could not be amended or changed without unanimous consent of the partners, but the agreement had to comply with laws and regulations or TGIFJV risked losing its lease. By refusing to agree to the amendments giving the DBE partners the level of control required by federal law, CBIF put TGIFJV in default and at risk of losing the entire venture. CBIF also demonstrated its pursuit of self-interest at the expense of TGIFJV and its partners when CBIF refused to waive its right of first refusal when Friday's sold a 10% interest to Domain to comply with the 35% DBE requirement, and CBIF only agreed to waive its right when Friday's paid CBIF \$109,000. Based on this evidence, the court of appeals concluded there was sufficient evidence to support the finding that CBIF breached its fiduciary duty to Friday's.

Next, the court of appeals concluded that there was sufficient evidence for the jury to find Flory individually liable for CBIF's breach of fiduciary duty because Flory knowingly participated in CBIF's breach. Under Texas law, a person is liable as a joint tortfeasor when the person "knowingly participates in a breach of fiduciary duty." To prevail on this claim, a plaintiff must prove a third party breached its fiduciary duty and that the defendant knew of the fiduciary relationship and was aware of his participation in the third party's breach of duty. Flory argued that he could not be held individually liable for CBIF's breach of fiduciary duty because he acted only in his capacity as manager of Columbia, the general partner of CBIF, and acted in good faith, believing that what he did was for the best interest of CBIF and Columbia. However, the case law relied on by Flory was a breach-of-contract and tortious-interference case, not a

breach-of-fiduciary-duty case, and the court stated that Flory's reliance on it was misplaced. The court also rejected the argument that an agent cannot be held liable for aiding and abetting breach of a fiduciary duty by the principal. The court stated that the case on which Flory and Columbia relied for this proposition did not reach the question of whether an agent might be held liable for aiding and abetting a principal's breach of fiduciary duty.

When instructing the jury in this case on knowing participation in a breach of fiduciary duty, the court defined "knowingly" as "actual awareness, at the time of the conduct, that a fiduciary duty was owed and that the fiduciary was breaching that fiduciary duty." The court further instructed the jury that "[a]ctual awareness may be inferred where objective manifestations indicate that a person acted with actual awareness." CBIF was a partner in TGIFJV, and the court of appeals characterized the relationship between partners as "fiduciary in character, and impos[ing] on all the participants the obligation of loyalty to the joint concern and of the utmost good faith, fairness, and honesty in their dealings with each other with respect to matters pertaining to the enterprise." Flory's testimony established that he knew of the fiduciary relationship between CBIF and its partners, but Flory argued that there was no evidence that he actually knew CBIF's actions were breaches of fiduciary duty owed to Friday's and that his testimony showed that he did not know CBIF was acting in breach of a fiduciary duty. According to the court, however, the jurors could have inferred Flory's actual awareness based on objective manifestations, such as Flory's management of CBIF, knowledge of the airport's DBE requirements, and actions preventing TGIFJV from complying with these requirements. In sum, Flory knew of CBIF's fiduciary relationship with the partners and it could be inferred that Flory had actual awareness of CBIF's breach of fiduciary duty, making Flory individually liable. The court also held that the trial court did not err in refusing to submit a jury question inquiring as to whether Columbia and Flory had a good-faith belief that they were entitled to take their actions based on the joint venture agreement. The court acknowledged that good faith is a defense to tortious interference but stated that it had found no authority extending this defense to a claim of knowing participation in a breach of fiduciary duty.

Flory and Columbia next challenged the sufficiency of the evidence supporting the jury's findings that they breached their fiduciary duties to TSQF. TSQF argued that CBIF and Columbia breached their fiduciary duties by using TSQF's money to fund a lawsuit against the RSH Group, by preventing TSQF from participating in a portion of CBIF's defaulted interest in one of the airport restaurants, by complicating TSQF's compliance with requirements of the DBE program, and by refusing to cooperate in adjusting TGIFJV to allow it to proceed at the airport for its purpose of operating Friday's restaurants. Columbia argued it could not be held liable for using TSQF funds to pay legal fees because the TSQF management services agreement authorized Columbia to obtain certain legal services and to pay for them with TSQF funds. However, the court pointed out that TSQF was managed by Texas Star as general partner, and Columbia's role in TSQF's management was very limited and administrative in nature. Despite this limited control, Columbia caused funds of TSQF to be used to pay legal fees incurred in a lawsuit Columbia and CBIF brought against the RSH Group. In doing so, Columbia "usurped Texas Star's general management role." CBIF was responsible for Columbia's actions because CBIF was a party to the lawsuit and acted through Columbia, its general partner. CBIF and Columbia also breached their fiduciary duties through Flory's lack of cooperation regarding TSQF's participation in a portion of CBIF's defaulted interest in one of the airport restaurants. CBIF and Columbia argued that they were not liable for breach of a fiduciary duty to TSQF because TSQF could not have participated in the new restaurant without a super-majority vote of its partners, which was not requested and would not have occurred because Columbia would not have voted in favor of the participation. The court stated that the argument that Columbia could not breach a fiduciary duty by exercising a contractual right was an argument

already rejected by the court earlier in its opinion. Columbia and Flory also argued that the trial court erred in refusing to instruct the jury that contractual rights supplant fiduciary duties. The court rejected this argument because “contractual rights do not ‘operate to the exclusion of fiduciary duties.’” Thus, the court of appeals concluded that the trial court did not err in refusing to submit the requested instruction that contractual rights supplant fiduciary duties, and there was sufficient evidence to support the jury’s finding that CBIF and Columbia breached their fiduciary duties to TSQF.

CBIF and Columbia also challenged the sufficiency of the evidence supporting the jury’s findings that they breached a fiduciary duty to the RSH Group. The RSH Group alleged CBIF and Columbia breached their fiduciary duties by refusing to agree to changes to the governing documents required to bring TSQF and TGIFJV into compliance with federal requirements regarding DBEs. Columbia argued it had no duty to agree to the proposed changes in the governing documents because the governing documents required unanimous consent to amend or modify them. Once again, the court stated that contractual rights do not operate to the exclusion of fiduciary duties and that contractual rights must be exercised in a manner consistent with fiduciary duties. The evidence showed that the airport required TGIFJV and TSQF to meet FAA guidelines for compliance or risk losing TGIFJV’s right to operate restaurants and café bars at the airport. The evidence also showed that CBIF and Columbia refused to amend the governing documents to give the DBEs the requisite levels of control over the venture and the partnership, which resulted in the airport condemning the lease as to one of the restaurants. Thus, the evidence was sufficient to support the jury’s findings of a breach of fiduciary duty to the RSH Group.

The court of appeals also rejected Flory’s challenge to the sufficiency of the evidence supporting the jury’s findings that he knowingly participated in CBIF’s and Columbia’s breach of fiduciary duty to TSQF and the RSH Group. CBIF was a limited partner in TSQF, and a limited partner owes a fiduciary duty to the partners and the partnership if the limited partner exercises control over the operation of the business. CBIF did not challenge findings by the jury that it exercised dominance and control over TSQF. Thus, CBIF owed TSQF and the RSH Group a fiduciary duty. Flory managed Columbia, and Columbia was the general partner of CBIF and a manager of TSQF. Thus, Columbia owed TSQF and the RSH Group a fiduciary duty. Flory knew of these fiduciary relationships, and the court concluded that the jury could have inferred Flory’s actual awareness of the breach based on Flory’s actions. Thus, the court held there was sufficient evidence to support the jury’s finding that Flory knowingly participated in CBIF’s and Columbia’s breach of fiduciary duties. Consistent with its earlier holding regarding Flory’s knowing participation in CBIF’s breach of fiduciary duty to Friday’s, the court held that the trial court did not err in refusing to submit an instruction on good-faith belief as a justification because justification is not a defense to knowing participation.

***Beninati v. Borghi***, 61 N.E.3d 476 (Mass. App. 2016).

The appellate court held that outsiders who participated in breaches of fiduciary duty by managers and employees of LLCs could be liable under the state unfair trade practices statute even though the statute does not apply to intracorporate disputes arising out of employment contract disputes or disputes between members of the organization arising out of the employment relationship.

Over a period of years, Anthony Beninati (Tony), Steven Borghi, and Joseph Masotta opened twelve health clubs (collectively, WOW New England), each of which was owned and operated through a separate LLC. Eight of the clubs were operated without written operating agreements. While Tony was alive, his wife Elizabeth did not actively participate in the management of the clubs.

Tony became ill with an incurable disease, and the accountant for WOW New England drafted written operating agreements for the eight LLCs that had no written operating agreement a month before Tony's death. The eight new agreements referred to "Anthony (Elizabeth) Beninati" as one of the members. After Tony's death in 2005, Elizabeth began to play a more active role. In 2010, Elizabeth, Borghi, and Masotta began to disagree about the direction of the business. Borghi wanted to expand more so than the others, and Borghi met another businessman, Dixon, with whom he formed a new business that eventually owned and operated thirteen health clubs in direct competition with WOW New England. Borghi arranged for Dixon to get access to proprietary information of WOW New England, which they used in running their new clubs. Borghi's wife, who was employed by WOW New England, also worked for the new clubs and funneled information from WOW New England to the new business. Without the knowledge of Elizabeth and Masotta, Borghi took various actions involving the use of the name licensed by WOW New England and its assets to further the business of the competing clubs. In 2011, the parties hired attorneys to look into the disputes that were brewing and to attempt to negotiate revised operating agreements to resolve the disputes. Eventually, Masotta, Borghi, and Dixon signed a side agreement, and Masotta, Borghi, and some minority owners of WOW New England—but not Elizabeth—signed revised operating agreements for the existing WOW New England clubs.

In 2012, Elizabeth sued Borghi and his wife, Dixon, Masotta, and the competing entities formed by Borghi and Dixon. In 2013, at a meeting of the WOW New England entities, there was a vote to remove the Borghis as managers, but the Borghis refused to acknowledge their removal, claiming that Elizabeth did not hold a voting interest. Elizabeth filed another action seeking to enforce the vote, and that action was consolidated with the first action. After trial, the trial court ruled that Elizabeth was a full voting member of the WOW New England companies and the 2011 amended and restated operating agreements were void. On Elizabeth's derivative claims, the trial court found that the Borghis, aided and abetted by Dixon, breached their fiduciary duties, and the court awarded damages and equitable relief. The trial court found no liability for unfair trade practices, reasoning that the statute does not apply to internal corporate disputes.

The appellate court found no error in the trial court's findings and relief regarding Elizabeth's status as a voting member and the meaning and effect of the operating agreements. However, the appellate court concluded that the trial court erred in concluding that Dixon and the competing entities formed by Borghi and Dixon could not be liable under the state unfair trade practices statute. The court explained that the Massachusetts unfair trade practices statute "was intended to refer to individuals acting in a business context in their dealings with other business persons and not to every commercial transaction whatsoever" and provides a cause of action for those "engaged in the conduct of any trade or commerce" who suffer damages "as a result of the use or employment by another person who engages in any trade or commerce of an unfair method of competition or an unfair or deceptive act or practice." The statute does not extend to employment contract disputes between an employer and employee or disputes between members of an organization arising out of the employment relationship. The plaintiffs did not challenge the trial court's ruling that Borghi and his wife could not be liable under the unfair trade practices statute because the statute does not apply to intracorporate disputes. However, the plaintiffs argued that the trial court erred in finding that Dixon and the entities that were formed to compete with WOW New England could not be liable under the statute. The trial court did not believe Dixon and the competing entities could be liable "[b]ecause any wrongdoing by Dixon is only as a result of his aiding and assisting the Borghis in breaching their fiduciary and contractual obligations that they owed WOW New England." The appellate court disagreed with the trial court. Although the unfair trade practices statute is inapplicable to employee-employer disputes, the appellate court pointed out that Dixon and the

competing entities were never employees of WOW New England. Additionally, the court stated that case law has “explicitly rejected the suggestion that, because an employee cannot be held liable to the company under [the unfair trade practices statute], outsiders who participate with the employee ‘in a violation of his duty of loyalty’ may not be liable under [the unfair trade practices statute].” The court discussed a case in which a corporate officer formed a competing corporation and diverted a corporate opportunity. In that case, the competing corporation was held liable under the unfair trade practices statute based on the competing corporation’s aiding and abetting of the officer’s breach of fiduciary duty to the plaintiff corporation. Similarly, the status of Borghi and his wife within WOW New England did not bar the plaintiffs’ unfair trade practices claims against Dixon and the competing entities. Because the trial judge believed that the unfair trade practices statute was inapplicable, she did not attempt to assess Dixon or the competing entities’ culpability under the statute. Whether the defendants violated the statute and whether they did so in a manner that would support multiplying the damages were matters to be determined by the trial court, and the appellate court thus remanded these matters for a determination by the trial court.

### **Interpretation of Operating Agreement**

*Johnson v. Crossett*, 408 P.3d 1272 (Idaho 2018).

Two men orally agreed to form an LLC in which one of them would take an active role as the manager and the other would not take part in the day-to-day business. The men also agreed to recruit an employee from a competing business with a view towards later admitting her as a member. The individual who agreed to manage the LLC recruited the employee and formed the LLC. After a written operating agreement was prepared with terms satisfactory to the parties, the inactive individual refused to sign the written operating agreement. Initially, the refusal was based on his desire to keep his role in the business a secret, but later the refusal was based on financial difficulties of the LLC. The individual who formed the LLC operated it for a period of time and eventually agreed to sell all the LLC’s assets to another company after the LLC’s financial difficulties continued. The purchasing company acquired the LLC’s assets in exchange for assumption of the LLC’s debts, which greatly exceeded the LLC’s assets. The inactive individual and the employee of the LLC filed suit alleging that they were members of the LLC since its inception and that they were improperly expelled. The trial court concluded that the plaintiffs never became members of the LLC, interpreting the oral agreement between the two men to require that the plaintiffs sign the written operating agreement to become members. The Idaho Supreme Court affirmed.

Johnson and Crossett agreed to form an LLC to operate a business similar to a business Johnson’s brother-in-law (“Brother-In-Law”) had started. Under the oral agreement reached by Johnson and Crossett (the “Oral Agreement”), Crossett would be the sole agent and manager, receive a fixed salary, and own a 46% interest. Johnson would not be involved in day-to-day operations or receive compensation but would own a 44% interest. The two men also agreed that Crossett would contact Cousins, an employee of Brother-In-Law’s company, to recruit her to work for their company. Cousins was hired in May 2013 and was to receive a 10% interest in the company at some point, but she was not a party to the Oral Agreement.

Crossett filed a certificate of organization to form the company as a single-member LLC in June 2013. By the end of July 2013, a written operating agreement (“Written Agreement”) was prepared and approved by Crossett and Johnson, but the agreement was never signed. The LLC opened for business in July 2013 and was sued by Brother-In-Law’s company. Johnson refused to sign the Written Agreement because he did not want Brother-In-Law or other members of his family to know he was associated with the LLC. The LLC’s business grew quickly and ran into cash flow



problems, bad publicity from Brother-In-Law's lawsuit, and large legal fees from defending the lawsuit. Cousins resigned in October 2014 and was paid all the money she was owed.

Late in 2014, Crossett insisted that Johnson sign the Written Agreement and join him in personally guaranteeing some of the legal fees owed the LLC's attorneys. Johnson refused and stated that these problems must be solved by Crossett. Johnson said he would not sign until the problems were resolved. Johnson and Crossett did not come to terms, and Crossett continued to operate the LLC as a single-member LLC. Johnson was eventually repaid what he invested in the LLC, but the LLC continued to have financial difficulties. Crossett outsourced the LLC's business to a new LLC he formed with another individual, and eventually Crossett agreed to sell the LLC's assets to the new company in exchange for the new company's assumption of the LLC's debts, which far exceeded the value of the LLC's assets.

After a two-day bench trial, the trial court found that the Oral Agreement served as an operating agreement for the LLC in that it was an agreement to operate the LLC until the Written Agreement was ready to be signed. Specifically, the district court found that the Oral Agreement provided that Johnson and Cousins would only become members once they signed the Written Agreement. The trial court also concluded that Crossett did not breach any fiduciary duties (because the plaintiffs were not members and were paid what they were owed) and was not liable for money he withdrew from the LLC (because the withdrawals did not exceed what he was owed for his managerial duties).

The court also rejected the plaintiffs' contention that the trial court erred in interpreting or applying the Idaho Uniform Limited Liability Company Act (the "LLC Act") by allowing the unsigned Written Agreement to undercut the parties' Oral Agreement. The plaintiffs argued that the trial court ignored the provision of the LLC Act that provided an operating agreement may be oral. The court stated that the plaintiffs took certain statements by the trial court out of context and that the trial court did not hold that an oral operating agreement may be undermined by the mere drafting of a written agreement. The court said the trial court "made clear that it was not the mere drafting of the Written Agreement, in the abstract, that undermined the Oral Agreement; rather, per the Oral Agreement, once the Written Agreement was ready to be signed, Appellants could only become members by signing."

Finally, the court held that the trial court did not err by awarding attorney's fees to Crossett under an Idaho statute that allows a prevailing party to recover attorney's fees when the gravamen of the lawsuit is a commercial transaction. The court cited a case in which members of an LLC brought individual and derivative claims against the founder of the LLC, and the court affirmed an award of attorney's fees on the individual claims pursuant to the statute regarding a commercial transaction and an award of attorney's fees on the derivative claims pursuant to the LLC Act. The court distinguished cases in the partnership and corporate context where attorney's fees were not recoverable because the gravamen of the actions related to enforcement of statutory provisions. Although the LLC Act was related to this action, the court said the gravamen of the action was a dispute over a claimed breach of contract, i.e., the Oral Agreement, which was a commercial transaction.

*Estate of Calderwood v. ACE Grp. Int'l, LLC*, 157 A.D.3d 190, 67 N.Y.S.3d 589 (App. Div. 1<sup>st</sup> Dept. 2017).

The court held that the rights of the estate of a deceased member of a Delaware LLC were limited by the LLC agreement to the rights of an assignee notwithstanding Section 18-705 of the Delaware Limited Liability Company Act, which provides that a deceased member's personal

representative may exercise all of the rights of the member for the purpose of settling the member's estate or administering the member's property.

Alex Calderwood formed an LLC with Ecoplace LLC ("Ecoplace"), an LLC controlled by Stefanos Economu. Calderwood died unexpectedly. At the time of his death, Calderwood held a majority stake in the LLC, which Ecoplace offered to purchase. The estate refused the offer and sued the LLC, Ecoplace, and Economu asserting numerous causes of action. The motion court dismissed several of the estate's claims, and the estate appealed.

First, the appellate court addressed the motion court's dismissal of the estate's claim for a declaration that the estate was a member of the LLC with all of Calderwood's rights. The defendants relied on the LLC agreement, but the estate argued that the Delaware LLC statute conferred the estate with all of Calderwood's rights notwithstanding the LLC agreement.

Section 9.7(b) of the LLC agreement provided:

Upon the death or disability of a Member ... (the "Withdrawing Member"), the Withdrawing Member shall cease to be a Member of the Company and the other Members and the Board shall ... have the right to treat such successor(s)-in-interest as assignee(s) of the Interest of the Withdrawing Member, with only such rights of an assignee of a limited liability company interest under the Act as are consistent with the other terms and provisions of this Agreement and with no other rights under this Agreement. Without limiting the generality of the foregoing, the successor(s)-in-interest of the Withdrawing Member shall only have the rights to Distributions provided in Sections 4 and 10.3, unless otherwise waived by the other Members in their sole discretion.

Section 18-705 of the Delaware LLC Act states:

If a member who is an individual dies ... the member's personal representative may exercise all of the member's rights for the purpose of settling the member's estate or administering the member's property, including any power under a limited liability company agreement of an assignee to become a member.

The estate argued that the statutory provision permitted the estate to exercise all of Calderwood's rights notwithstanding the limitations in the LLC agreement, but the court responded by recognizing that the parties to an LLC agreement have substantial latitude to shape their own affairs and that the primary function of the statute is to fill gaps in the LLC agreement. The estate argued that Section 18-705 controlled over the LLC agreement because Section 18-705 does not contain the proviso "unless otherwise provided in the limited liability company agreement," but the court rejected that argument on the basis of Delaware case law finding that another provision of the LLC statute lacking such a proviso was nonetheless permissive and subject to modification. The court also found it notable that Section 18-705 contains the phrase "may exercise," which Delaware case law has stated indicates a "voluntary, not mandatory or exclusive, set of options." The court also rejected the estate's argument that the policy of protecting vulnerable heirs supported the conclusion that Section 18-705 is mandatory under Delaware law. The court quoted Delaware case law stressing the primacy of contract in the LLC context and concluded: "[W]hether section 18-705 is mandatory or permissive, we, nonetheless, find that in this case it does not override section 9.7(b) of the LLC Agreement."

The court next rejected the estate's contention that the LLC agreement did not unambiguously abrogate Section 18-705 of the Delaware LLC Act. First, the court noted that any conflict between the LLC agreement and the statute should be resolved in favor of the LLC agreement. Second, the court concluded that the LLC agreement was not susceptible to different interpretations, but clearly stated the consequences of the death of a member.

The estate also argued that a determination that the estate was not a member of the LLC would lead to an absurd result because the majority owner would have no participation or control rights while the minority owner would have full control. The court did not view such a result as absurd, pointing to Delaware case law recognizing the distinction between tolerating a new passive co-investor that one did not choose and enduring a new co-manager without consent.

The court next concluded that the estate's claim for a declaration that it was owed fiduciary duties by the managing member was based on a "strained interpretation" of Delaware law and was properly dismissed by the motion court. The estate characterized itself as a party bound by the LLC agreement and argued that Ecoplace, as a managing member of the LLC, and Economou, who controlled Ecoplace, owed the estate fiduciary duties. (In a footnote, the court noted that the estate did not, and could not, argue that the LLC owed it a fiduciary duty because an LLC does not owe a fiduciary duty to a member and thus does not owe a duty to a non-member.) The estate relied on *Feeley v. NHAOCG, LLC*, 62 A.3d 649, 661 (Del. Ch. 2012) and Sections 18-1101 and 18-1104 of the Delaware LLC Act for the proposition that LLC managers owe fiduciary duties to others bound by the LLC agreement unless the duties are expressly disclaimed. The court stated that the estate's pronouncement that it was a party bound by the LLC agreement and its reliance on "default" fiduciary duties were unfounded. The court said the *Feeley* court did not explain what is meant by "otherwise bound by a limited liability company agreement" in Section 18-1101(c). The court said the case law considering the term has arisen in the context of creditors of the LLC rather than a successor-in-interest, and the court also stated that the Delaware Supreme Court has called into question whether the Delaware LLC Act imposes "default" fiduciary duties, citing *Gatz Properties, LLC v. Auriga Capital Corp.*, 59 A.3d 1206, 1219 (Del. 2012). (The court did not discuss the amendment of Section 18-1104 after the *Gatz* case to provide that "the rules of law and equity relating to fiduciary duties ... shall govern.") The court pointed out that the court in *Feeley* was dealing with a dispute between a managing-member and a nonmanaging-member and did not address if or when fiduciary duties are owed by a member to a nonmember. The court stated that its decision did not impact causes of action asserted by the estate in its amended complaint for breach of contract based on the duty of good faith and fair dealing related to its rights to distributions and its alleged right to call Ecoplace's interest.

***State v. Bruun***, 405 P.3d 905 (Utah App. 2017).

The appellate court affirmed the convictions of two individuals on multiple theft charges based on checks written on the operating account of a real estate development LLC controlled by the individuals. The checks at issue represented expenditures on development projects other than the project specifically identified in the LLC's operating agreement. The individuals argued that the operating agreement and Utah Revised Limited Liability Company Act authorized the use of LLC funds on other projects, but the court rejected these arguments.

A Utah couple (the "Victims") agreed to sell twenty-nine acres (the "Property") to Equity Partners LLC ("Equity Partners"), which was indirectly owned and controlled by two individuals (the "defendants"). The Victims and the defendants formed Tivoli Properties, LLC ("Tivoli") to develop the Property. Equity Partners was the managing member and owned 75% of Tivoli, and the Victims owned 25% of Tivoli. Unbeknownst to the Victims, Tivoli entered into an agreement to develop

other property and spent thousands of dollars on expenditures for projects unrelated to the Property. The defendants were charged with and convicted of multiple theft charges based on the expenditures. Under Utah law, theft requires proof that a defendant “obtains or exercises unauthorized control over the property of another with a purpose to deprive him thereof.” The defendants argued that their actions were authorized by Tivoli’s operating agreement (the “OA”) and the Utah Revised Limited Liability Company Act (the “LLC Act”).

The appellate court first addressed the defendants’ argument that the trial court should have determined as a matter of law that the OA authorized the defendants’ use of Tivoli funds for other development projects. The court discussed provisions of the OA that addressed Tivoli’s purpose and business and concluded that the broad description of the LLC’s business could be read to be limited by a provision that described the purpose of the LLC with reference to the Property or any other enterprise upon which the members mutually agreed. In view of this purpose provision, the court stated that there was a reasonable basis to conclude that the LLC’s authorized business activities were limited to development of the Property unless the members mutually agreed otherwise, and the OA did not unambiguously authorize joint ventures between Tivoli and other entities for development of property other than the Property.

The court also addressed a related question regarding the defendants’ managerial authority to make the expenditures that were the basis of the theft convictions. The defendants relied on broad provisions in the OA addressing powers of managers, policies, and conduct of the company, but the State pointed to other provisions that limited the managers’ authority to take certain actions. The court stated that these constraints could reasonably be interpreted to apply to the defendants’ actions. Given the limitations imposed by the OA on the broad authority conferred on the managers, the court was not persuaded that the OA unambiguously authorized the defendants to make the non-Property-related expenditures that were the basis of the theft convictions.

The court acknowledged that there were provisions from which the jury might reasonably have concluded that the parties to the OA intended to engage broadly in real estate development and make expenditures like those at issue, but there were other provisions reasonably supporting a conclusion that the parties intended Tivoli’s business to be limited to development of the Property. There was extensive evidence presented at trial regarding the meaning of the OA. Given the ambiguity of the OA and the substantial conflicting evidence regarding its meaning, the court held that the trial court properly submitted to the jury the issue of whether the defendants were authorized to make the expenditures based on the language of the OA and other evidence regarding the parties’ intent.

The defendants alternatively argued that the LLC Act authorized the defendants’ decisions to use Tivoli’s funds for other projects. Because this issue was not preserved by the defendants for appeal, the defendants had to establish plain error or ineffective assistance of counsel for relief based on this contention. The appellate court was not persuaded that it would have been obvious to the trial court or counsel for the defendants that the LLC Act dictated a result different from the result in this case.

The defendants contended that the LLC Act authorized their use of Tivoli’s funds to make the expenditures at issue because the defendants indirectly owned 75% of Tivoli, and the LLC Act permits members owning 2/3 of the interests in an LLC to take actions in contravention of the operating agreement or the stated purpose of the LLC. The defendants relied on Section 804(4) of the LLC Act, which provides that no manager has authority to do any act in contravention of the articles of organization or operating agreement except as provided by subsection (6)(g). Subsection (6)(g) states that “unless otherwise provided by the operating agreement of the company;...(g) approval by:...(ii) members holding 2/3 of the profits interests in the company, and 2/3 of the

managers shall be required for all matters described in” subsection 803(3) of the LLC Act. Subsection 803(3) lists actions, including an act outside the ordinary course of business or substantial change to the business purpose of the company, that may be taken with 2/3 approval of the members. The defendants argued that the most logical interpretation of subsection 804(4)’s proviso excepting management actions described in subsection 804(6)(g) from the constraints of an operating agreement, requires that subsection 804(6)’s prefatory proviso, that the actions may be taken “unless otherwise provided in ... the operating agreement,” not apply once subsection 804(4) has been invoked. The defendants argued that the reference to subsection (6)(g) means (6)(g) alone, without the prefatory proviso of subsection (6). According to the defendants, subsection 804(4) would never be applicable if the 804(6) prefatory proviso applies, because a manager could never act in contravention of an operating agreement since an action in contravention of the operating agreement would mean that the operating agreement “otherwise provides” a prohibition against the action. The defendants also argued that the State’s contrary interpretation (which would give effect to an OA provision that required consent of all members for any amendment to the OA, change in character of the business, significant and material purchase, or act that would make it impossible to carry on the ordinary business) was circular and inconsistent with the purposes of the LLC Act to afford flexibility to LLC members. According to the defendants, one way to achieve flexibility to the members ““is to permit those with the biggest stakes ... in conjunction with those who have been given management authority to take actions in a more flexible and timely manner.””

The court acknowledged that there was some logic to the defendants’ interpretation and that it revealed a potential inconsistency in the statute if subsection 804(6)’s introductory proviso is included when subsection 804(4) is invoked. However, it was not obvious to the court that 804(4) is meant to incorporate 804(6)(g) without 804(6)’s qualification giving primacy to the operating agreement, especially in light of the LLC Act’s overarching policy elevating the provisions agreed to by members in the operating agreement over the default provisions of the Act. The court also was not convinced that giving effect to the introductory proviso with (6)(g) necessarily renders subsection 804(4) a nullity. Even assuming that it would, however, the court was not persuaded that the trial court committed plain error by submitting the issue to the jury or that the defendants’ trial counsel performed deficiently by failing to make the argument that the defendants now made on appeal given the LLC Act’s express statement that the Act is intended to give maximum effect to freedom of contract and the enforceability of operating agreements and the presence of other provisions in the Act aimed at giving primacy to the operating agreement over contrary default provisions in the statute.

***Miller v. FiberLight, LLC***, 808 S.E.2d 75 (Ga. App. 2017).

A minority member of a Delaware LLC sued the majority members and chair of the board for breach of fiduciary duty and breach of the implied covenant of good faith and fair dealing in connection with amendments to the operating agreement, termination of his employment and redemption of his interest, and rejection of offers to purchase the company. Although the court rejected the defendants’ argument that provisions of the LLC agreement eliminated fiduciary duties, the court affirmed the trial court’s summary judgment that the defendants did not breach any default fiduciary duties in connection with the amendments or the termination of the plaintiff’s employment and redemption of his interest. At the time of the first amendment of which the plaintiff complained, the defendants were not yet majority members owing any fiduciary duties. The subsequent actions taken by the defendants when they owed fiduciary duties were expressly allowed by the LLC agreement as previously amended, so there was no breach of fiduciary duty or breach of the implied covenant of good faith and fair dealing.

Miller and several other parties entered into an operating agreement for a Delaware LLC, and the agreement was amended on multiple occasions. Miller complained that he was coerced by economic duress (threats of termination) to agree to the third, fourth, and fifth amended and restated operating agreements. The amended operating agreements enabled the defendants to reduce his interest and redeem it when he eventually was terminated.

Miller relied on default fiduciary duties under Delaware law in asserting his breach-of-fiduciary-duty claims. The defendants argued that fiduciary duties were eliminated by provisions of the operating agreement, but the court held that none of the provisions relied upon by the defendants explicitly eliminated fiduciary duties. In support of the defendants' claim that the default duty of care was eliminated, the defendants relied on exculpation provisions of the operating agreements that provided there would be no right, claim, or cause of action against any director or member for acting or failing to act in accordance with the director's or member's rights or obligations under the operating agreement. In support of their contention that the default duty of loyalty was eliminated, the defendants' relied on a provision of the operating agreement allowing members to participate in other business opportunities and compete with the LLC. The defendants also argued that the entire-agreement clause eliminated default fiduciary duties. The court rejected the defendants' arguments and stated that none of the provisions relied upon by the defendants plainly, unambiguously, or explicitly eliminated default fiduciary duties. Thus, default fiduciary duties applied to the decisions challenged by Miller in this case. The court went on to conclude, however, that most of Miller's claims for breach of fiduciary duty failed.

The third amended agreement made many changes, including converting more than \$10 million in debt owed to the LLC's largest creditors into equity, thereby making the creditors the majority members of the LLC. The amendments also added a provision requiring redemption of an individual member's interest on termination of the individual's employment as well as provisions changing the structure and voting of the board so that appointees of the new majority members would have unilateral authority to take action, including amendment of the LLC agreement (which previously required unanimous consent of the members). Miller claimed that the defendants breached fiduciary duties to him by coercing him to sign the third amended operating agreement by threats of termination, but this claim failed because the defendants were not majority members when Miller signed the third amended agreement and thus owed him no fiduciary duties at the time. Furthermore, the defendants did not have the authority to terminate Miller at that time.

The court next addressed Miller's claim that the fourth and fifth amended agreements, pursuant to which his interest was diminished, should be disregarded because his consent to those agreements was coerced. The court held that the failure of Miller's claim as to the third amended agreement defeated his claims that the defendants breached their fiduciary duties by enforcing the fourth and fifth amended agreements because the third amended agreement gave the majority members the unilateral right to enact the fourth and fifth agreements regardless of whether Miller consented. The court said that it had found no Delaware authority to support the proposition that a party breaches a fiduciary duty by taking action specifically authorized under an LLC agreement. The court said Delaware law was clear that provisions in an LLC's operating agreement supersede default fiduciary duties.

The court also rejected Miller's claim that the defendants breached default fiduciary duties by redeeming his interest in the LLC upon his termination, again relying on the proposition that a party who takes action specifically authorized under an LLC agreement does not breach a default fiduciary duty.

Miller next argued that the trial court erred in granting the defendants summary judgment on his claim for breach of the implied covenant of good faith and fair dealing. The trial court ruled that there was no breach because the agreements allowed the defendants to terminate Miller and redeem his membership interests. Miller argued that he should be allowed to pursue this claim regardless of whether the agreements allowed redemption of his membership interests because the covenant protects reasonable expectations, and he expected and was given reassurance that he would receive a substantial return on his investment in LLC. The court rejected this argument on the basis that the implied covenant cannot be used to override express provisions of a contract. Miller also argued that his claim for breach of the implied covenant was supported by a provision of the agreement stating that removal of an officer did not affect the rights of the officer as a member, but the court stated that the specific language in a contract controls over the general, and the agreement specifically allowed redemption of Miller's interest.

*Han v. Official Committee of Unsecured Creditors (In re Kang)*, 664 Fed. App'x 336 (4<sup>th</sup> Cir. 2016).

The court of appeals agreed with the district court and bankruptcy court that transfers of direct and indirect interests in an LLC were void (not merely voidable and subject to equitable defenses) because the transfers violated the terms of the LLC's operating agreement. The court rejected the argument that the failure of an individual named as a member in the operating agreement to sign the agreement precluded the operating agreement from becoming effective.

In 2004, an LLC was formed to acquire, develop, and manage a shopping center. When it was formed, the LLC was wholly owned and managed by Grand Equity, LLC (Grand Equity), which was in turn wholly owned and managed by Grand Development, LLC (Grand Development). Grand Development was wholly owned and managed by the debtors, Min and Mik Kang. In 2005, the LLC refinanced its property, and a newly formed entity, Grand Formation, Inc. (Grand Formation) became the managing member of the LLC and acquired a .5% interest. Grand Equity's interest decreased from 100% to 99.5%. Grand Formation and Grand Equity executed a new operating agreement, which listed an individual as the "Independent Member." The individual never signed the agreement and testified that he was never a member. The operating agreement contained restrictions on transfer by the LLC's direct and indirect owners of more than 49% of the LLC's ownership. The transfer restrictions tracked restrictions contained in the deed of trust executed in the refinancing. In 2008, the Virginia Corporation Commission cancelled the existence of both Grand Equity and Grand Development for nonpayment of annual registration fees, and the property of those entities passed to the Kangs under the Virginia LLC statute. In 2009, the Kangs effectively agreed to sell 60% of their interests in the LLC and Grand Formation to two individuals, Yeon Han and John Sohn, in violation of the terms of the 2005 operating agreement.

The bankruptcy trustee sought and obtained from the bankruptcy court a declaration that the 2009 sale was null and void. Sohn settled with the trustee after the bankruptcy court's ruling, but Han appealed, and the district court affirmed that ruling. On appeal to the court of appeals, Han argued that: (1) the trustee lacked standing; (2) the 2005 operating agreement never became effective and did not govern the 2009 sale of interests; and (3) even if the 2005 operating agreement governed, the 2009 sale was not null and void.

With regard to the threshold issue of standing, Han contended that the trustee lacked standing to assert his claim because the Kangs, in whose shoes the trustee stood, did not have a direct interest in the LLC, but only an interest in the LLCs that controlled it. However, the court pointed out that a Chapter 11 trustee has the power to assert the rights of the debtor and creditors under state law, and the property of the cancelled LLCs passed "automatically" under Virginia law to the managers,

members, or interest holders, as trustees in liquidation to distribute the LLC's assets after winding up. When Grand Equity and Grand Development were cancelled in 2008, their interests in the LLC were held in trust by the Kangs. As the LLCs were only "pass-through entities with no business to wind up or outstanding debts to pay," the interests they held in the LLC passed directly to the Kangs. Stepping into the Kangs' shoes, the trustee thus had standing to pursue the claim that the 2009 sale was null and void.

Han next argued that the 2005 operating agreement never became effective because one of the members never agreed to the agreement. The court acknowledged that the agreement named Ronnie Kim, along with Grand Formation and Grand Equity, as a member of the LLC, but the court stated that a person cannot become a member without agreeing to do so. Kim testified that he had never been a member of the LLC and had not seen the 2005 operating agreement or even heard of the LLC before preparing for his deposition. Because Kim was never a member of the LLC, the 2005 operating agreement became effective without his agreement.

Finally, Han argued that the violations of the 2005 operating agreement only rendered the 2009 sale voidable, rather than null and void, thus allowing her to raise equitable defenses such as estoppel. Specifically, Han argued that an operating agreement is merely an agreement among its members, and that the trustee could be estopped to deny that the debtors had the power to consummate the sale just as the debtors could be estopped. The court rejected this argument, explaining that an operating agreement binds the parties to the agreement under Virginia law. Further, under the Virginia LLC statute, the parties can "provide rights to any person, including a person who is not a party to the operating agreement, to the extent set forth in the operating agreement." Han admitted that the restrictions in the 2005 operating agreement were designed to benefit the lender and that the transfer violated the control provisions of the 2005 operating agreement. The court stated that few courts appear to have spoken on the issue of whether a prohibited transfer such as this is void or voidable, but the court cited a Florida case as an example of the tendency of courts to conclude that actions that violate an LLC's operating agreement are null and void. The court here likewise concluded "that such actions are without legal effect because they exceed the scope of authority conferred by the operating agreement." The court agreed with the district court that "operating agreements define the authority of LLCs, and companies that engage in transactions with an LLC appropriately look to these agreements during the due-diligence process to determine such authority. Actions taken outside the authority conferred by the operating agreement are thus ultra vires and without legal effect." Because the 2009 sale violated the 2005 operating agreement, it was null and void.

*Adweiss, LLLP v. Daum*, 208 So.3d 760 (Fla. App. 2016).

The court held that, under Delaware law, a provision of an LLC's operating agreement requiring the LLC to "indemnify, defend, and hold harmless" required advancement of attorney's fees and costs.

A Florida limited liability limited partnership and its general partner, a Delaware LLC, appealed from an order awarding the defendants advancement of fees and costs based on a provision of the LLC's limited liability company agreement that provided as follows:

6.6. *Indemnity.* The Company shall indemnify, **defend** and hold harmless (i) the Managers, (ii) any person designated to act on behalf of the Managers, ... (severally, the "Indemnitee" and collectively, the "Indemnities"), from and against any claims, losses, liabilities, damages, fines, penalties, costs and expenses (including, without limitations, fees and disbursements of counsel and other professionals) arising out



of or in connection with any act or failure to act by an Indemnitee pursuant to this Agreement, or the business and affairs of the Company, to the fullest extent permitted by law; provided, however, that the Company shall not be required to indemnify an Indemnitee for any loss or damage which the Indemnitee may incur as a result of such Indemnitee's willful misconduct or gross negligence. (emphasis added).

The principal issue on appeal was whether inclusion of the term “defend” in the phrase “indemnify, defend and hold harmless” in the paragraph above provides for the advancement of attorney’s fees and costs to the defendants for their defense of the action filed by the plaintiffs. The plaintiffs argued that the provision provides for indemnification, but not advancement. Relying on Delaware case law, the court disagreed with the plaintiffs. According to the court, the plaintiffs’ interpretation would render inclusion of the term “defend” meaningless and would run afoul of the Delaware Supreme Court’s instruction that the court “‘give each provision and term effect, so as not to render any part of the contract mere surplusage.’” Even though the terms “advancement” and “advance” are not used in the provision at issue, the court stated that Delaware courts have suggested that the term “defend” means something more than indemnify. The court pointed out that the Delaware Court of Chancery in *Majkowski v. American Imaging Management Services, Inc.*, 913 A.2d 572 (Del. Ch. 2006), rejected Majkowski's argument that he was entitled to advancement based on a provision in an LLC agreement that provided the company “shall indemnify and hold harmless” the members and their affiliates. Although the court referred to the provision as “‘a standard, straight-forward indemnification provision, devoid of any advancement rights’” the court indicated that Majkowski would have had a stronger argument if the agreement “‘used the word “defend,”...because the obligation to “defend” comes closer to suggesting the active employment of attorneys and continual payment as the attorneys’ fees are incurred.’” The court also relied on a Delaware Supreme Court decision discussing a provision in a merger agreement that imposed a duty to “indemnify” but not a duty to “defend.” Based on these Delaware cases, the court affirmed the trial court’s determination that the phrase “indemnify, defend and hold harmless” entitled the defendants to advancement of attorney’s fees and costs to defend the action filed against them by the plaintiffs. The court stated that “[a]ny other holding would render the term ‘defend’ meaningless.”

***Beninati v. Borghi***, 61 N.E.3d 476 (Mass. App. 2016).

The appellate court agreed with the trial court’s determination that numerous LLC operating agreements were ambiguous regarding the status of a deceased member’s wife, and the appellate court found no error in the trial court’s factual finding that the parties intended for the deceased member’s wife to take the place of the deceased member on his death. The appellate court also found no error in the trial court’s finding that two other operating agreements were amended by the conduct of the parties to substitute the wife of the deceased member as a member on the death of her husband. Finally, the appellate court held that the trial court did not err in setting aside amendments of the operating agreements, on the basis that “manifest justice and fairness” required that the amendments not be binding, where the amendments stripped the wife of her voting membership without her consent.

Over a period of years, Anthony Beninati (Tony), Steven Borghi, and Joseph Masotta opened twelve health clubs (collectively, WOW New England), each of which was owned and operated through a separate LLC. Eight of the clubs were operated without written operating agreements. While Tony was alive, his wife Elizabeth did not actively participate in the management of the clubs. Tony became ill with an incurable disease, and the accountant for WOW New England drafted written operating agreements for the eight LLCs that had no written operating agreement a month

before Tony's death. The eight new agreements referred to "Anthony (Elizabeth) Beninati" as one of the members. After Tony's death in 2005, Elizabeth began to play a more active role. In 2010, Elizabeth, Borghi, and Masotta began to disagree about the direction of the business. Borghi wanted to expand more so than the others, and Borghi met another businessman, Dixon, with whom he formed a new business that eventually owned and operated thirteen health clubs in direct competition with WOW New England. Borghi arranged for Dixon to get access to proprietary information of WOW New England, which they used in running their new clubs. Borghi's wife, who was employed by WOW New England, also worked for the new clubs and funneled information from WOW New England to the new business. Without the knowledge of Elizabeth and Masotta, Borghi took various actions involving the use of the name licensed by WOW New England and its assets to further the business of the competing clubs. In 2011, the parties hired attorneys to look into the disputes that were brewing and to attempt to negotiate revised operating agreements to resolve the disputes. Eventually, Masotta, Borghi, and Dixon signed a side agreement, and Masotta, Borghi, and some minority owners of WOW New England—but not Elizabeth—signed revised operating agreements for the existing WOW New England clubs.

In 2012, Elizabeth sued Borghi and his wife, Dixon, Masotta, and the competing entities formed by Borghi and Dixon. In 2013, at a meeting of the WOW New England entities, there was a vote to remove the Borghis as managers, but the Borghis refused to acknowledge their removal, claiming that Elizabeth did not hold a voting interest. Elizabeth filed another action seeking to enforce the vote, and that action was consolidated with the first action. After trial, the trial court ruled that Elizabeth was a full voting member of the WOW New England companies and the 2011 amended and restated operating agreements were void. On Elizabeth's derivative claims, the trial court found that the Borghis, aided and abetted by Dixon, breached their fiduciary duties, and the court awarded damages and equitable relief. The trial court found no liability for unfair trade practices, reasoning that the statute does not apply to internal corporate disputes.

As a threshold matter, the appellate court agreed with the trial court's determination that the eight operating agreements referring to "Anthony (Elizabeth) Beninati" as a member were facially ambiguous. The meaning of the insertion of "(Elizabeth)" in the listing of "Anthony (Elizabeth) Beninati" as a member at the beginning of the agreements created an ambiguity because the agreements then apportioned a percentage share to "Anthony Beninati" and were signed only by Anthony Beninati. Considering the extrinsic evidence that was presented, the appellate court could find no clear error in the trial court's factual determination that the parties meant for Elizabeth to have a voting membership in the eight clubs governed by these operating agreements upon Tony's death. The evidence indicated that Tony instructed WOW New England's accountant, in anticipation of his death from a terminal illness, to draft operating agreements to reflect that he held his interests jointly with Elizabeth. Borghi and Masotta decided not to hold their interests jointly with their spouses. After Tony's death, the others treated Elizabeth as a full voting member and did not question her status until litigation appeared imminent. The trial court considered conflicting evidence, such as estate tax returns treating Tony's WOW New England ownership interests as being held individually rather than jointly with Elizabeth, but determined, on balance, that the parties intended the agreements to reflect that Elizabeth would step into Tony's place after his death. In view of the differing inferences that could be drawn from the evidence, the appellate court deferred to the trial court on this matter.

The appellate court also upheld the trial court's conclusion that the two operating agreements that did not refer to Elizabeth were amended by the conduct of the parties to substitute Elizabeth for Tony. There was ample testimony and documentary evidence that the parties treated Elizabeth as a

full participant in these two companies and did not adhere to the provisions differentiating between voting and nonvoting membership.

Finally, the appellate court concluded that the trial court also did not err in setting aside the 2011 amended operating agreements that stripped Elizabeth of her voting membership without her consent. The trial court “determined that “[m]anifest justice and fairness require that this Court not recognize [the June 2011 operating agreements] as binding.”” These amended agreements were entered into after Borghi and Dixon partnered to launch a competing business, usurped the WOW trade name, and used proprietary and other confidential WOW New England information. When the agreements were signed, Masotta was unaware of all of the actions of Borghi and Dixon, and the trial court found Masotta’s consent to the operating agreements “was essentially paid for” by a side agreement pursuant to which he was to receive a \$10,000 payoff. The trial court determined Borghi and Masotta had conflicts of interest disqualifying them from voting to amend the operating agreements and found that the 2011 amended agreements could not stand. The appellate court “discern[ed] no clear error of fact or abuse of discretion” on the part of the trial court in this regard.

Since Elizabeth became a full voting member in the LLCs when Tony died, and the 2011 amended operating agreements were invalid, Elizabeth had the status of a full voting member when she and Masotta called the 2013 meeting of the WOW New England membership and voted to remove the Borghis as managers, and the trial court did not err in enforcing the vote to remove the Borghis.

***Demir v. Schollmeier***, 199 So.3d 442 (Fla. App. 2016).

The court held that an LLC member was not personally liable to a withdrawing member for the return of the withdrawing member’s capital contribution under a contribution agreement entered into by the members. The court discussed the nature of an LLC operating agreement and concluded that the contribution agreement constituted an operating agreement within the meaning of the Florida LLC statute even though the agreement at issue was not called an “operating agreement.” The court determined that the obligation to return the withdrawing member’s capital contribution set forth in the agreement (which provided that the withdrawing member’s capital contribution “shall be reimbursed” but did not explicitly provide by whom) was the obligation of the LLC rather than the obligation of the other members.

After Demir formed Avrupa, LLC for the purpose of operating a night club, Demir, Schollmeier, and Demir’s brother entered into an agreement entitled “Avrupa, LLC Contribution Agreement.” The agreement provided that Schollmeier was contributing \$400,000 to the LLC for a 20% interest, and the other two members were contributing \$1,000,000 for 40% interests in the LLC. The agreement also provided that ““Schollmeier may decide to withdraw from ownership of [Avrupa], in which case Schollmeier’s contribution of \$400,000.00 U.S. shall be reimbursed.”” The night club operated for only a short time, and Schollmeier elected to withdraw from the LLC and demanded return of his capital contribution. When the funds were not returned, Schollmeier sued Demir seeking \$400,000 in damages for breach of contract. The trial court entered summary judgment in favor of Schollmeier against Demir for breach of the agreement, and Demir appealed.

The court of appeals disagreed with the trial court’s determination that the agreement between Demir, Schollmeier, and Demir’s brother was not an operating agreement under the Florida Limited Liability Company Act, but rather a personal contract solely governing the terms of Schollmeier’s contribution to the LLC. Based on the statutory definition of an operating agreement (an agreement that may be entered into by all of the members to regulate the affairs of the LLC and the conduct of its business, to establish duties, and to govern the relations among the members, managers, and company), the court of appeals concluded that the agreement in this case was an

operating agreement even though it was not called an “operating agreement” and was not entered into until after the LLC was formed as an LLC. The court noted that the agreement even stated that it was “a limited liability company agreement under and as provided by the [Florida Limited Liability Company] Act.” Drawing on its decision in *Dinuro Investments, LLC v. Camacho*, 141 So.3d 731, 742 (Fla. 3d DCA 2014), the court explained that an operating agreement is a contract, but that, “unlike a typical bilateral contract, where both signing parties owe duties to one another, operating agreements establish a more complicated and nuanced set of contractual rights and duties.” The court further explained that “[o]perating agreements govern the relations among the members, the managers, and the limited liability company itself, as well as the effect of these relations with third parties,” which the court stated is an important distinction “because the signing parties to an operating agreement may very well decide that no individual member owes the other members any duties whatsoever, and that those duties are owed only to the company.” The court also stated “that ‘the precise terms of the agreement are critical’ in determining whether a party has breached a contractual duty.”

Schollmeier argued that he was entitled to recover his capital contribution from Demir personally because the agreement provided that “Schollmeier may decide to withdraw from ownership of [Avrupa], in which case Schollmeier’s contribution of \$400,000.00 U.S. shall be reimbursed.” However, the court pointed out provisions of the agreement that stated that the contributions were being made to the LLC by wiring funds to the LLC’s bank account as well as provisions addressing the effect of potential increases and decreases of contributions on each member’s interest in the LLC and a provision that the LLC would not pay interest on capital contributions. These provisions led the court to conclude that Schollmeier’s contribution was to be reimbursed to him by the LLC when he withdrew from ownership of the LLC. “To read these provisions to mean that the individual Members of Avrupa are required to reimburse a capital contribution explicitly made to only the company is to read more into the Agreement than what its Members agreed upon.” Emphasizing the liability protection provided to participants in an LLC, the court again quoted its opinion in *Dinuro*:

Conspicuously missing from the operating agreement is any provision stating that the members shall be directly liable to each other for breaches of the terms of the operating agreement. Absent such a stipulation, we presume individual members are not liable for obligations or decisions of the company, as limited liability is one of the paramount reasons for forming an LLC. Section 608.4227 of the Florida Statutes specifically provides that members are typically shielded from individual liability for their involvement with an LLC unless the terms of the articles of organization or the operating agreement provide otherwise.

If the parties intended to provide that a member would be personally liable for any of the LLC’s obligations, including the obligation to reimburse a member’s capital contribution, the court said that the member’s obligation needed to be explicit. Because the agreement did “not authorize a Member to bring a direct action against another Member for a breach of its terms,” the court held that Schollmeier was not entitled to reimbursement of his capital contribution to the LLC from Demir.

## **Entity Nature of LLC; LLC Property**

***State v. Bruun***, 405 P.3d 905 (Utah App. 2017).

The appellate court affirmed the convictions of two individuals on multiple theft charges based on checks written on the operating account of a real estate development LLC controlled by the individuals through another entity that owned 75% of the LLC and was the managing member. The checks at issue represented expenditures on development projects other than the project specifically identified in the LLC's operating agreement. The individuals argued that the operating agreement and Utah Revised Limited Liability Company Act authorized the use of LLC funds on other projects, but the court rejected these arguments. The defendants argued that the trial court should have instructed the jury that the value of the allegedly stolen property was not more than 25% of the checks at issue because the defendants owned 75% of the allegedly stolen funds. The court rejected this argument because it is no defense to theft under Utah law that the actor has an interest in the stolen property if another person also has an interest that the actor is not entitled to infringe. The court relied on a case in which it had previously rejected a similar argument in the partnership context, and the court further relied on the separate legal existence of an LLC from its members and the distinction between LLC property and the interest of the members.

## **Capacity of Dissolved LLC**

***Midwest Renewable Energy, LLC v. Am. Eng'g Testing, Inc.***, 894 N.W.2d 221 (Neb. 2017).

The plaintiff brought this quiet title action against a Nevada LLC that obtained a judgment lien against the plaintiff's property based on a judgment obtained in California. Before the plaintiff filed its quiet title action, the LLC dissolved and transferred its assets to its members. On appeal, the Nebraska Supreme Court determined that Nevada law, rather than Nebraska law, governed the question of whether the dissolved LLC was amenable to suit, and the court held that the LLC was amenable to suit under Nevada law.

The court began by noting that the amenability of a dissolved LLC to suit was a matter of first impression, but the court stated that it had considered the issue in the corporate context and has looked at principles of corporate law when addressing similar functions of LLCs because an LLC is “a hybrid of the partnership and corporate forms.” The court explained that amenability of the dissolved LLC to suit in Nebraska depended on whether Nebraska or Nevada law applied because the survival statutes applicable to LLCs in Nebraska and Nevada differ. The Nebraska statute extends a dissolved LLC's ability to sue and be sued during the winding up process, whereas the Nevada statute permits an LLC to sue and be sued for two years after it has filed articles of dissolution if the suit could have been initiated before the filing. The LLC filed its articles of dissolution in November of 2013 with an effective date of December 31, 2013. The court characterized the winding up process as beginning when the articles of dissolution were filed and completed on December 31, 2013, thus precluding the LLC from defending or enforcing its rights under Nebraska law because the action was brought in September of 2014. However, because the LLC's judgment lien was created before the LLC's dissolution, and the quiet title action was brought within 2 years of the filing of the articles of dissolution, the court stated that the dissolved LLC was able to defend itself under Nevada law.

To determine whether Nebraska or Nevada law applied in this case, the court considered the internal affairs doctrine. The court explained that the internal affairs doctrine “recognized that only one state should have authority to regulate a corporation's internal affairs—matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholder—because otherwise, a corporation could be faced with conflicting demands.” The court

noted that the internal affairs doctrine is codified in the Nebraska corporate statute as well as the Nebraska LLC statute, which is based on the Revised Uniform Limited Liability Company Act. The court pointed out that the comments to RULLCA (adopted by the Nebraska legislature) reference Restatement (Second) Conflict of Laws § 302. The court also looked to Section 299 of the Restatement, which specifically addresses choice of law in the context of deciding what law applies to a dissolved corporation's continued existence for purposes of suing or being sued. Relying on these provisions of the Restatement and case law in other jurisdictions applying the internal affairs doctrine to fully dissolved corporations, the court concluded that Nevada's statute governed the dissolved LLC's capacity to sue or be sued. Because the suit was brought against the dissolved LLC within two years of its dissolution, the dissolved LLC could defend itself in this action. The court went on to address the plaintiff's argument that the dissolved LLC could only be defended in the name of its trustees. The court acknowledged that the Nevada statute confers on the trustees of a dissolved LLC the full power to defend suits on behalf of the dissolved LLC, but the court did not interpret the provision to be exclusive of the dissolved LLC's power to defend itself in its own name. Ultimately, however, the court determined that disputes regarding the ownership, validity, and subsistence of the judgment and judgment lien could not be litigated without the joinder of the managing member, who was an indispensable party because of his claim that the LLC transferred the judgment and judgment lien to him.

### **Effect of Dissolution and Reinstatement**

*In re Reinstatement of S&D Roofing, LLC*, 202 So.3d 177 (La. Ct. App. 2016).

The court of appeals reviewed the provisions of the Louisiana LLC statute providing for dissolution of an LLC by filing an affidavit and reinstatement of such an LLC, and the court held that the trial court did not err in reinstating the LLC prospectively, rather than retroactively, in view of the silence of the statute regarding the retroactive effect and public policy considerations in this case.

After a judgment creditor of a voluntarily dissolved LLC sought to seize the personal assets of the members to satisfy the creditor's default judgment against the LLC, the LLC's two members filed a petition to reinstate the LLC. The provision under which the LLC dissolved in this case provides for dissolution of an LLC that is no longer doing business and has no debts by the filing of an affidavit of its members. After dissolution, the members are personally liable for any debts of the LLC in proportion to their membership interests. A court may order reinstatement of an LLC previously dissolved by affidavit, but the statute is silent as to whether the reinstatement has a retroactive effect. The trial court ordered reinstatement of the LLC prospectively, and the members appealed, arguing that the reinstatement should be given retroactive effect in order to perfect service of the notice of default judgment on the LLC and to facilitate proper representation of the LLC.

In the absence of Louisiana case law directly addressing the issue, the appellate court considered the statutory reinstatement provision in its broader context and noted that several other reinstatement provisions applicable to LLCs (e.g., reinstatement after revocation of an LLC's articles of organization after failure to file an annual report for three years and reinstatement after failure to maintain a registered office or registered agent) expressly provide for retroactive effect. The court interpreted the legislature's silence regarding retroactive effect of a reinstatement after dissolution by affidavit to reflect the legislature's intent that such a reinstatement not be given retroactive effect. The court also looked by analogy to cases addressing the analogous matter of reinstatement of corporations dissolved by affidavit. In the absence of express statutory guidance on the matter of retroactive reinstatement of corporations, the court explained that Louisiana courts have primarily relied on considerations of public policy, emphasizing what the shareholders knew prior to

dissolution and what purpose motivated dissolution and reinstatement. The court noted that, throughout the various contexts in which courts have addressed corporate reinstatements, Louisiana courts have consistently applied the principle that reinstatement, retroactive or not, cannot operate to shield shareholders from personal liability. The court found the corporate cases instructive in this context and concluded that public policy considerations did not weigh in favor of retroactive effect of the reinstatement of the LLC at issue. When the members dissolved the LLC, they exposed themselves to “any debts and claims against it” under the statute, and the only apparent purpose served by retroactive reinstatement of the LLC’s status would be to shield the members from personal liability. With no statutory authority permitting retroactive reinstatement and public policy considerations disfavoring it in this case, the court found no error in the district court’s prospective reinstatement of the LLC.

***CF SBC Pledgor 1 2012-1 Trust v. Clark/School, LLC***, 78 N.E.3d 381 (Ill. App. 2016).

The court held that the relation-back effect of the reinstatement provision of the Illinois LLC statute did not operate to continue an administratively dissolved and reinstated LLC’s existence without interruption for purposes of avoiding default under a loan agreement that required the LLC to maintain its existence. Although the LLC had been administratively dissolved before the plaintiff filed its action for foreclosure against the LLC, the LLC later reinstated and sought to avoid foreclosure by relying on the reinstatement provision of the Illinois LLC statute, which provided that the LLC’s “existence shall be deemed continued without interruption from the date of the issuance of the notice of dissolution” and that the LLC was “revived...as if it had not been dissolved,” and that “all acts and proceedings of its members or managers, acting or purporting to act in that capacity, that would have been legal and valid but for the dissolution, shall stand ratified and confirmed.” In the absence of case law in the LLC context addressing this provision, the court considered corporate cases interpreting a similarly worded relation-back provision in the Illinois corporate statute. The court concluded that the LLC statute’s relation-back provision did not operate to prevent the LLC’s dissolution from constituting an event of default under the loan agreement. According to the court, “[t]he relation-back provision allows a reinstated LLC to ratify actions taken on its behalf while it was dissolved but, like the relation-back provision in the Business Corporation Act, cannot impose a legal fiction that belies actual, real-world, facts.” The loan agreement did not address the effect of reinstatement, and the court concluded that the LLC’s failure to maintain its status triggered a default under the plain language of the agreement, which was voluntarily and freely entered into by the LLC.

***Ivey Brookside, LLC v. White (In re White)***, 556 B.R. 489 (Bankr. N.D. Ok. 2016).

The court dismissed this adversary proceeding (in which the plaintiff sought to establish nondischargeability of the debtor’s debt to the plaintiff) because the plaintiff LLC filed the proceeding after the LLC’s articles of organization were cancelled (due to the LLC’s failure to file the annual certificate required to be filed under the Oklahoma LLC statute) and before the LLC reinstated its articles of organization. The court held that the reinstatement did not “relate back” to ratify actions taken in the name of the LLC while it was a nonentity. The court discussed the LLC statute and numerous cases in the corporate and LLC context in reaching its conclusion that the LLC statute did not provide for retroactive effect of the reinstatement. The statute was silent as to whether a reinstatement has retroactive effect and the court found nothing in the statutory language suggesting that a reinstatement has any retroactive effect. The plaintiff argued that failure to file its annual certificate and fees was a technical oversight and that dismissal would be an inequitable and unfair result given that the oversight had been cured and that dismissal would effectively be with prejudice since the deadline to file a nondischargeability complaint had passed. The court

acknowledged that the result was “unfortunate” for the plaintiff, but the court did not view the result as inequitable or unfair. According to the court, the plain language of the statute indicated that the result was consistent with the intent of the Oklahoma legislature. [In 2017, the Oklahoma LLC statute was amended to provide that reinstatement “relates back” to the cancellation and “takes effect as if its articles of organization had never been canceled.”]

### **Charging Order**

***Stanfield v. On Target Consulting, LLC***, 90 N.E.3d 962 (Ohio App. 2017).

An individual’s tax returns showing income from an LLC and filings made by the LLC with the Ohio Division of Liquor Control naming the individual as “owner,” “manager,” and “partner” of the LLC were not “records of the limited liability company” for purposes of determining that the individual was a member. When determining whether a person is a member of an LLC, a court must consider records that are maintained by the LLC for the purpose of its corporate governance and that name owners entitled to receive distributions and share in profits and losses of the LLC.

A judgment creditor obtained charging orders against the judgment debtor’s alleged interests in three LLCs. Although the operating agreements of the LLCs did not list the judgment debtor as a member, the tax returns of the judgment debtor showed income from the three LLCs, and documents filed by the LLCs with the Ohio Department of Commerce–Division of Liquor Control listed the judgment debtor alternately as “owner,” “manager,” and “partner.” On appeal, the judgment debtor argued that the operating agreements established that he was not a member and that the trial court erred in granting the charging orders.

The Ohio LLC statute permits a judgment creditor of a member to apply for an order charging the membership interest of the member, and the statute defines a “member” as “a person whose name appears on the records of the limited liability company as the owner of a membership interest in that company.” Ohio Rev. Code § 1705.01(G). A “membership interest” is “a member’s share of the profits and losses of a limited liability company and the right to receive distributions from that company.” Ohio Rev. Code § 1705.01(H). The judgment debtor argued that the operating agreements conclusively established that he was not a member of the LLCs, but the judgment creditor argued that the records from the Division of Liquor Control were “records of the limited liability company” because the statute does not define the phrase or limit such records to the operating agreement. The judgment creditor argued that “records of the limited liability company” should include any document that “records or documents past events” of the LLC—in essence, any document generated by the LLC in the normal course of business.

The court rejected the judgment creditor’s proposed definition of “records of the limited liability company” as unworkably broad and found it instructive to look at the statutory provision listing the records required to be kept by an LLC at its principal office. The court said that all of the listed records are required to be maintained for purposes of the LLC’s corporate governance. According to the court, limiting “records of the limited liability company” to documents involving corporate governance that establish a membership interest in an LLC is consistent with the statutory record keeping requirement, provides the most reliable information regarding the LLC’s structure and operation, and guides the trial court as to what records to examine to determine whose name appears as an owner “entitled to receive distributions and share in the profits and losses.” Thus, to determine who is a member of an LLC for purposes of issuance of a charging order, a court must consider records that are maintained by the LLC for the purpose of its corporate governance and that name those owners entitled to receive distributions and share in the profits and losses of the company.



Based on the definition of “records of the limited liability company” adopted by the court, the judgment creditor failed to produce evidence that the judgment debtor was a member of any of the three LLCs at issue. The filings with the Division of Liquor Control were documents relating to the LLC’s business operation, not its corporate governance, and the judgment debtor’s tax returns were not documents of any of the three LLCs. The only “records” of the three LLCs before the trial court were the operating agreements, which showed that the judgment debtor was not a member of any of the three LLCs. The trial court thus erred when it granted the motion for the charging orders.

***JPMorgan Chase Bank, N.A. v. McClure***, 393 P.3d 955 (Colo. 2017).

The Colorado Supreme Court addressed the relative priority of competing charging orders against a foreign judgment debtor’s membership interests in several Colorado LLCs. The court held that the membership interest of a non-Colorado citizen in a Colorado LLC is located in Colorado and that a foreign charging order that compels action by a Colorado LLC is ineffective against the LLC until the judgment creditor has taken sufficient steps in Colorado to obligate the LLC to comply with the order. In this case, the Colorado charging orders obtained by the respondents after domestication of a foreign judgment took priority over the petitioner’s foreign charging orders (even though the petitioner obtained and domesticated its foreign judgment and served its foreign charging orders on the Colorado LLCs before the respondents obtained and domesticated their foreign judgment and obtained Colorado charging orders) because the petitioner did not obtain Colorado charging orders and did not domesticate its foreign charging orders until after the respondent obtained and served Colorado charging orders.

The court first reviewed and explained the statutory remedy of a charging order and stated that, under Colorado law, the lien created by a charging order generally attaches at the time the order is served on the LLC. That order of service ordinarily determines the order of priority of competing charging orders regardless of the order in which the competing creditors’ judgments were entered.

Next the court addressed the location of a membership interest in a Colorado LLC. The court acknowledged that the case law is divided as to whether a membership interest (intangible personal property) is located where the member is located or where the LLC was formed. The court agreed with the Washington Supreme Court in *Koh v. Inno-Pacific Holdings, Ltd.*, 54 P.3d 1270 (Wash. 2002) that a member’s membership interest is located where the LLC was formed for purposes of determining the enforceability of a charging order. The court identified two reasons supporting this conclusion. First, the charging order is, as a practical matter, a mechanism that requires an LLC to take action, i.e., to redirect the debtor member’s distributions to the creditor. Thus, the court deemed it more appropriate to place the membership interest in the state where the LLC, and thus the membership interest, was created, rather than the state where the debtor member happens to be domiciled at the time. Second, in the court’s view, justice and convenience weigh in favor of locating the membership interest in the state of formation of the LLC because substantial uncertainty and confusion could result from deeming the interest to be located wherever the member is domiciled inasmuch as multiple jurisdictions might be involved in the litigation and an LLC could face the burden of determining which of several orders are binding on it.

The court next turned to the priority of the charging orders at issue in this case. After obtaining a judgment in Arizona against an Arizona resident, JPMorgan Chase Bank, N.A. (Chase) obtained charging orders from the Arizona court against the debtor’s membership interests in several Colorado LLCs. The charging orders were sought and obtained under the Arizona LLC statute. The McClures, holders of competing charging orders obtained in Colorado after domesticating their own Arizona judgment against the debtor, argued that Chase’s charging orders were invalid because the Arizona charging order statute applies only to LLCs organized under Arizona law. The court found

it unnecessary to address this question because, even assuming Arizona law authorizes charging orders against interests in foreign LLCs, the court ultimately concluded that Chase's charging orders were not entitled to priority over the McClures' charging orders.

In analyzing the priority question, the court placed significance on the fact that the charging orders at issue were not only liens, but also specifically ordered the LLCs to act, i.e., to pay Chase any distributions to which the judgment debtor would be entitled. To be effective, a charging order that compels an LLC to act must bind the LLC, and the question thus becomes what action a judgment creditor must take to make a charging order enforceable against the LLC from which the order requires action. The court noted that its analysis of this question was based on its understanding that the Colorado LLCs involved in this case were not registered to do business in Arizona nor did they have any other connection with Arizona other than the fact that one of their members was sued in Arizona and had judgments against him entered there. Assuming without deciding that the court's analysis should be based on the trial court's personal jurisdiction over the judgment debtor, the court did not see how the exercise of such jurisdiction by the Arizona trial court could force the Colorado LLCs to act, and the court knew of no authority that would support the Arizona trial court's in rem jurisdiction over the membership interests located in Colorado. Thus, approaching the analysis as involving in rem jurisdiction over the membership interest, a charging order in this case would not be enforceable unless it was issued by a Colorado court—i.e., the state in which the LLCs, and thus the membership interests, were formed and are located. Chase domesticated its Arizona judgment in Colorado and then domesticated its Arizona charging orders, and the court stated that it was unclear whether Chase's actions could be deemed the equivalent of obtaining Colorado charging orders based on a domesticated judgment (which is what the McClures did). However, even assuming Chase's actions could be considered the equivalent of obtaining Colorado charging orders, Chase did not obtain enforceable charging orders until it domesticated the Arizona charging orders, which it did not do until after the McClures had obtained and served enforceable Colorado charging orders on the LLCs. Assuming without deciding that the court's analysis must be predicated on the trial court's personal jurisdiction over the LLC, a judgment creditor who obtains a judgment against a member in a state in which the LLC is not subject to personal jurisdiction will need to domesticate the judgment in the LLC's state of formation and seek a charging order from a competent court in that state. Again assuming without deciding that domesticating the Arizona charging orders was the equivalent of obtaining Colorado charging orders, Chase did not domesticate its charging orders in Colorado until after the McClures had obtained and served effective charging orders on the LLC. Thus, approaching the analysis as implicating either in rem jurisdiction over the judgment debtor's membership interest or personal jurisdiction over the LLCs, Chase did not obtain enforceable charging orders, if at all, until after the McClures had already obtained and served effective charging orders, and the McClures' charging orders thus had priority.

***Gillet v. ZUPT, LLC***, 523 S.W.3d 749 (Tex. App. 2017).

In a case of first impression in Texas, the court of appeals held that a charging order was not the exclusive remedy of an LLC judgment creditor where the LLC judgment creditor sought to reach the membership interest of one of its own members to enforce a judgment obtained by the LLC against its member. Under the circumstances in this case, the court held that the trial court did not err in granting a turnover order in favor of the LLC against the member's membership interest.

A 45% member sued an LLC to enforce a buy-out of the member's interest under a buy-sell agreement, and the LLC counterclaimed for misappropriation of trade secrets of the LLC. An arbitrator awarded each party damages and declined to offset the damages. The arbitrator determined

that the LLC owed the member \$499,050 for the value of his 45% interest plus attorney's fees. The arbitration award stated that the member's ownership interest would cease upon receipt of payment and the member was ordered to surrender all indicia of ownership on receipt of payment. The arbitrator also determined that the member breached his fiduciary duty to the LLC and that the LLC was entitled to damages in the amount of \$1,870,164 plus attorney's fees. The trial court confirmed the arbitration award and granted the LLC a turnover order and appointment of a receiver to collect non-exempt property to apply to the judgments. The member appealed, arguing that the trial court erred in granting a turnover order because a charging order was the exclusive remedy available against his membership interest. The court of appeals noted that the question of whether a charging order is the exclusive remedy when the judgment creditor is the LLC in which the judgment debtor owns a membership interest was an apparent case of first impression. The court held that requiring turnover of a membership interest in these circumstances was proper for two reasons. First, the reasoning behind the exclusivity of the charging order (to prevent the creditor of an owner from disrupting the business by a forced sale of the owner's interest and causing injustice to the other owners) is inapposite when the judgment creditor seeking the membership interest is the same entity from which the membership derives. Second, unlike a case in which a judgment creditor is seeking to collect on a money judgment by forcing a sale of a membership interest, this case involved an explicit award of the interest from one party to the other as part of the judgment.

***Pajoo v. Royal W. Inv. LLC, Series E***, 518 S.W.3d 557 (Tex. App. 2017).

The court of appeals analyzed the exclusivity provisions of the LLC and limited partnership charging order provisions of the Texas Business Organizations Code and concluded that the trial court erred in permitting a receiver to assume control of assets of a limited partnership, but the court upheld the trial court's turnover and receivership order against the LLC general partner pursuant to the turnover provision of the Texas Civil Practice and Remedies Code, as well as its order of receivership over the LLC and the individual who owned 99% of the LLC and the limited partnership under the receivership provision of the Texas Civil Practice and Remedies Code, concluding that these orders were appropriate measures to effectuate the charging orders issued with respect to the ownership interests in those entities.

A judgment creditor sought to enforce a judgment against two judgment debtors, Pajoo and U.S. Capital Investments, LLC ("US Capital"). Pajoo was the 99% limited partner of County Investment, LP ("County Investment"), and Pajoo also owned 99% of U.S. Capital, the 1% general partner of County Investment. County Investment held assets valued at approximately \$4 million, including commercial real estate, the Lexus SUV driven by Pajoo, antique cars, antique rugs, oil paintings, and other investments. The judgment creditor obtained a charging order against Pajoo's membership interest in U.S. Capital and a charging order against the partnership interests of Pajoo and U.S. Capital in County Investment. The trial court also entered a turnover order and appointed a receiver under the Texas Civil Practice and Remedies Code. Although the trial court originally entered a receivership order that expressly excepted the partnership and membership interests of the judgment debtors from the receiver's powers over the judgment debtors' assets, the trial court entered an amended order that appointed a receiver over all nonexempt assets of Pajoo and U.S. Capital, "including (but not limited to) their interest in County Investment L.P." A portion of the receivership order authorized the receiver to take control of assets of County Investment. On appeal, Pajoo and U.S. Capital argued that the trial court erred in appointing a receiver.

The court of appeals analyzed the exclusivity provisions of the limited partnership and limited liability company charging order provisions of the Texas Business Organizations Code and concluded that the trial court erred in permitting the receiver to assume control of assets of County

Investment. The Texas Business Organizations Code provides that a charging order is the exclusive remedy by which a creditor of a partner, member, or other owner of an interest in a partnership or LLC may satisfy a judgment out of the judgment debtor's interest in the partnership or LLC. In the course of its discussion, the court distinguished and refused to follow opinions in other jurisdictions in which courts did not confine relief to a charging order in the context of single-member LLCs. The court also rejected the argument that the plain text of the statute vitiated fraudulent transfer laws, stating that "to the extent that a debtor is shown to have fraudulently transferred an asset to a partnership in which the debtor has a partnership interest, the creditor's remedies are not limited to the debtor's partnership interest. Instead, the creditor is authorized to obtain an avoidance of the fraudulent transfer to the extent necessary to satisfy the creditor's claim, as well as other remedies under the Uniform Fraudulent Transfer Act." The court commented that there was no apparent conflict in this case between fraudulent transfer laws and the exclusivity provision since the judgment creditor did not allege any fraudulent transfer. Based on the plain statutory text of the exclusivity provision, the court of appeals held that the trial court erred by imposing a receivership and turnover order as to County Investment and as to Pajoooh's U.S. Capital membership interest.

The court of appeals upheld the trial court's turnover and receivership order against U.S. Capital pursuant to the turnover provisions of the Texas Civil Practice and Remedies Code, as well as its order of receivership over U.S. Capital and Pajoooh under the receivership provision, concluding that these orders were appropriate measures to effectuate the charging orders. While acknowledging that the charging order is the exclusive remedy by which a judgment creditor of a partner may satisfy a judgment from the judgment debtor's partnership interest, the court stated that a judgment creditor is not deprived of procedures to put the charging order into effect. A turnover order and receivership may be used to reach both present and future rights to nonexempt property that cannot be readily attached or levied on by ordinary legal process, and the court thus concluded that a turnover and receivership order may be used to monitor distributions and effectuate a charging order. Here the court viewed the turnover and receivership order against U.S. Capital as an appropriate measure to monitor distributions from County Investment and effectuate the existing charging order in favor of the judgment creditor. Likewise, the court of appeals concluded that receivership over U.S. Capital and Pajoooh (under a receivership provision in the Texas Civil Practice and Remedies Code permitting a court to appoint a receiver in any case in which a receiver may be appointed under the rules of equity) was appropriate based on a threat of serious injury to the judgment creditor. The parties disputed whether money Pajoooh had been receiving from County Investment was salary or a distribution subject to the charging order, and the court stated that Pajoooh's de facto domination of County Investment could obstruct the enforcement of the charging orders. The court noted that the judgment creditor may never collect on the judgment because it could not compel a distribution by County Investment, but the court of appeals recognized that the trial court could have found a threat that County Investment's assets could dissipate into the hands of the judgment debtors without the judgment creditor's knowledge or a meaningful opportunity to seek to have distributions remitted to the judgment creditor.

See *Curci Invs., LLC v. Baldwin*, 14 Cal.App.5<sup>th</sup> 214 (Cal. App. 4<sup>th</sup> Dist. 2017), under the heading "Veil Piercing" above, in which the California court held that the California charging order statute did not preclude the equitable remedy of reverse veil piercing.

## Governing Law

See *Estate of Calderwood v. ACE Grp. Int'l, LLC*, 157 A.D.3d 190, 67 N.Y.S.3d 589 (App. Div. 1<sup>st</sup> Dept. 2017), under the headings “Admission of Member,” “Fiduciary Duties,” and “Interpretation of Operating Agreement,” in which the court applied Delaware law in determining whether the estate of a deceased member of a Delaware LLC became a member of the LLC and whether fiduciary duties were owed to the estate by the managing member, but held that the estate’s claims for constructive trust and an accounting were governed by New York law.

See *Midwest Renewable Energy, LLC v. Am. Eng’g Testing, Inc.*, 894 N.W.2d 221 (Neb. 2017), under the heading “Capacity of Dissolved LLC” above, in which the Nebraska Supreme Court determined that Nevada law, rather than Nebraska law, governed the question of whether the dissolved LLC was amenable to suit.

See *A.V.E.L.A., Inc. v. Estate of Marilyn Monroe, LLC*, 241 F.Supp.3d 461 (S.D.N.Y. 2017), under the heading “Veil Piercing” above, in which the court looked to Delaware law to address the issue of whether the liability of a Delaware LLC could be imposed on another LLC based on the alter-ego theory because “New York’s choice of law rules provide that the law of the state of incorporation determines when the corporate form will be disregarded and liability will be imposed on shareholders.”

See *JPMorgan Chase Bank, N.A. v. McClure*, 393 P.3d 955 (Colo. 2017), under the heading “Charging Order” above, in which the Colorado Supreme Court addressed the relative priority of competing charging orders against an Arizona judgment debtor’s membership interests in several Colorado LLCs. One judgment creditor argued that the charging orders obtained by the other judgment creditor from an Arizona court under the Arizona LLC statute were invalid because the Arizona charging order statute applies only to LLCs organized under Arizona law. The court found it unnecessary to address this question because, even assuming Arizona law authorizes charging orders against interests in foreign LLCs, the court ultimately concluded that the charging orders issued in Arizona were not entitled to priority over charging orders issued in Colorado before the Arizona charging orders were domesticated in Colorado.