

Selected Recent LLC Cases

**ALI-ABA Limited Liability Entities Update 2012
April 10, 2012**

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LLC Veil Piercing

Martin v. Freeman, __ P.3d __, 2012 WL 311660 (Colo. App. 2012).

An LLC contracted with Martin for Martin to construct an airplane hangar, and the LLC sued Martin in 2006 for breach of the construction contract. In 2007, while the litigation was pending, the LLC sold its only asset, an airplane, for \$300,000 and distributed the proceeds to the LLC's sole member/manager, who paid the LLC's litigation expenses. In 2008, a judgment was entered in favor of the LLC, and Martin appealed. In that appeal, the court of appeals determined that the LLC's damages were speculative and remanded the case with instructions to enter judgment for Martin. On remand, the court declared Martin the prevailing party and awarded him \$36,645 in costs. Martin initiated this action to pierce the veil of the LLC and hold the member personally liable for the costs in the previous case. The trial court pierced the veil, and the court of appeals affirmed on appeal.

The court of appeals stated that, in order to pierce the LLC veil, the court must conclude (1) the corporate entity is an alter ego or mere instrumentality; (2) the corporate form was used to perpetrate a fraud or defeat a rightful claim; and (3) an equitable result would be achieved by disregarding the corporate form. The court addressed the defendants' argument that the first and second prongs were not satisfied. (Although the caption identifies the LLC as a Delaware LLC, there is no indication that any question regarding the governing law was raised, and the court applied Colorado law without discussion of any conflict-of-laws issue.) The court listed nine factors that are considered in determining alter ego status and listed the following findings of the trial court with regard to the alter ego determination: commingling of the LLC's assets with the member's personal assets and the assets of another LLC owned by the member; maintenance of negligible corporate records by the LLC; inadequate records concerning the LLC's substantive transactions; facilitation of misuse by a single individual serving as the sole member and manager; thin capitalization of the LLC; undocumented infusions of cash to pay the LLC's operating expenses, including litigation expenses; the fact that the LLC was never operated as an active business; disregard of legal formalities; the member's payment of the LLC's debts without characterizing the transactions; use of the LLC's assets for non-entity purposes in that the plane was used by the member's other LLC without agreement or compensation; operation of the LLC as a mere assetless shell and diversion of the proceeds of sale of its only significant asset to the member's personal account. The defendants argued that: LLCs have fewer restrictions than corporations concerning maintenance of formal records; member-owners are permitted to fund LLCs; thin capitalization is not a reason to disregard the corporate form; and third-party payment of attorney fees is proper. The court of appeals, however, concluded that the trial court considered the appropriate factors and that its findings supported the conclusion that the LLC was the member's alter ego.

The defendants also argued that the trial court erred in finding that the second prong of veil piercing was satisfied because the court did not find wrongful intent or bad faith. The court of appeals rejected this argument, concluding that showing the corporate form was used to defeat a creditor's rightful claim is sufficient and that further proof of wrongful intent or bad faith is not required to pierce the veil. In finding that the corporate form was used to defeat a rightful claim, the trial court relied upon the LLC's sale of its only asset and diversion of the proceeds to the member during litigation with Martin. The defendants argued that the sale of the airplane in 2007 did not support the second prong because Martin did not have a rightful claim until the cost award in 2009. The court of appeals concluded that defeating a *potential* creditor's rightful claim is sufficient to support the second prong. The court stated that the member drained the LLC of all assets during litigation while the LLC was exposed to liability because it had sued Martin. Without a finding of veil piercing, the court stated that leaving the LLC with no assets would have defeated Martin's potential claims. The defendants further argued that the second prong was not satisfied because the trial court found that all of the known or reasonably possible debts were fully provided for at the time of the distribution. The court of appeals held that this finding was not relevant to the veil-piercing analysis because it was made in analyzing Martin's claim that the defendants violated the Colorado statutory restriction on distributions by an LLC.

A strenuous dissent argued that the majority's decision was contrary to controlling Colorado precedent requiring the party seeking to pierce the veil to prove, at a minimum, wrongful conduct in the use of the corporate form.

Grand Legacy, LLP v. Gant, 66 So.3d 137 (Miss. 2011).

Gant, an individual, had a letter of intent to purchase property, and Gant offered to sell the property to Grand Legacy, LLP ("Grand Legacy") once Gant purchased the property. Grand Legacy agreed to purchase the property through a partnership to be formed in the future with Gant. Gant executed a contract of sale to purchase the property from its current owner. A second contract of sale, specifying the seller as Gant and the purchaser as a limited partnership to be formed between Grand Legacy and Gant, was executed. Eventually, a limited partnership consisting of Grand Legacy as the general partner and Gant & Shivers, LLC (an LLC owned by Gant and another individual, Shivers) as the limited partner, was formed to purchase the property. Subsequently, the contract of sale with Gant as seller was amended to make the LLC the seller. The purchase of the property closed in simultaneously closings of the sale of the property to the LLC and from the LLC to the limited partnership. Grand Legacy claimed that it did not learn until over two years later that Gant, Shivers, and their LLC profited from the transaction by selling the property to the limited partnership for more than the LLC paid for the property. Grand Legacy and the limited partnership sued Gant, Shivers, and the LLC for fraud and breach of fiduciary duty, but the supreme court upheld the trial court's summary judgment in favor of the defendants. Alleged oral statements made prior to formation of the limited partnership were held to be of no force and effect because of merger clauses in the sales contracts. Further, although the court found that the partners in the limited partnership owed duties of loyalty and care and a duty to account for profits derived from any transaction connected with the formation of the partnership without consent of the other partners, the court concluded that disclosure of the difference in sales price in an acknowledgment provided at closing was sufficient to satisfy the duty of the LLC as a partner in the limited partnership. The court also addressed a separate summary judgment motion on the part of Shivers as to his individual liability.

The plaintiffs argued that Shivers had personal liability for his role in the alleged fraud of the LLC. Shivers argued that he was protected from personal liability by the Mississippi LLC statute, but the plaintiffs argued that the LLC shield is inapplicable to a member's own acts or omissions and that the LLC veil may be pierced when fraud is involved. The plaintiffs argued that Shivers' signature on an allegedly false HUD-1 statement should subject him to liability. The court distinguished cases from other jurisdictions in which LLC statutes state that the liability shield does not apply to a person's "own acts or conduct." The court also distinguished a case in which a member was found liable for conduct before formation of the LLC. Here, the court pointed out that all of Shivers' actions took place after the formation of the LLC and that a court applying a statute identical to the Mississippi statute held that the mere act of signing a contract on behalf of an LLC in the capacity of member did not make the individual a signatory in his individual capacity. The plaintiffs further argued that the veil of an LLC may be pierced where fraud or misrepresentation is involved. The court again distinguished case law from other jurisdictions as involving evidence dissimilar to that in this case or law that did not control. The court stated that "[t]he law of Delaware, as applied by its own courts and those of other jurisdictions, 'allows a court to pierce the corporate veil of an entity when there is fraud....'" Since the trial court applied a Mississippi statute, however, the supreme court stated that "Delaware business-association law, however persuasive, does not lead to a finding of error."

***Town of Lebanon v. East Lebanon Auto Sales LLC*, 25 A.3d 950 (Me. 2011).**

The town of Lebanon filed a land use complaint against an LLC land owner and the sole member of the LLC based on the use of the property as an illegal automobile graveyard and junkyard. The trial court rendered a judgment against the LLC and the individual member. There was no dispute that the individual was the sole member of the LLC land owner as well as another LLC that operated the business on the property, and the trial court found that "[the member] and her various corporations and entities appeared to be closely inter-connected and fully under her control." The Maine Supreme Court concluded that this finding was insufficient to hold the member personally liable. The court cited the liability protection provided by the Maine LLC statute and stated that a plaintiff may not hold a member individually liable unless the plaintiff demonstrates, at a minimum, that (1) the individual abused the privilege of a separate corporate identity, and (2) an unjust or inequitable result would occur if the court recognized the separate corporate existence. The court stated that the record contained no evidence that suggested, and the trial court made no findings, that the member abused the privilege of incorporating or that an unjust result would occur if only the LLC were held liable on the town's complaint.

***Rednour Properties, LLC v. Spangler Roof Services, LLC*, ___ S.W.3d ___, 2011 WL 2535330 (Ky. App. 2011).**

The court of appeals held that the trial court did not err in holding Rednour, an individual who was the sole member of Rednour Properties, LLC, personally liable under the alter ego theory on a contract for roofing work on an apartment complex managed by Rednour Properties, LLC. In support of its veil piercing argument, the roofing contractor pointed out that Rednour Blake, LLC (the LLC that owned the apartment complex at the time of the contract) transferred ownership of the apartment complex to its wholly owned subsidiary, that there was testimony showing a lack of distinction between Rednour and the various LLCs owned by him, and that the contract at issue

listed Rednour Properties, LLC as the owner of the apartment complex when it was owned by Rednour Blake, LLC. The roofing contractor also stated that all three of the LLCs were owned by Rednour and that he signed the contract without specifying that he was acting in a corporate capacity. The court acknowledged that the record established the corporate existence of the LLCs at issue but stated that it was obvious that the LLCs were “‘dummy’ corporations” designed to protect Rednour from personal liability. The court noted that the individual was the sole member and agent of the companies and several others, at least one of which was a subsidiary of another LLC, and Rednour admitted to having set up the LLCs for tax purposes. “Under these circumstances, [the court was] unable to discern any difference between Rednour and his various LLCs.”

No Standing of Creditors to Sue Derivatively on Behalf of Insolvent LLC Under Delaware Law

CML V, LLC v. Bax, 28 A.3d 1037 (Del. 2011).

The Delaware Supreme Court agreed with the chancery court in this case that creditors of an insolvent Delaware LLC do not have standing to sue derivatively for breach of fiduciary duty to the LLC. A creditor of an insolvent LLC asserted derivative claims on behalf of the LLC for breach of fiduciary duty by the managers in connection with certain acquisitions and sales by the LLC. The chancery court dismissed the claims for lack of standing because the Delaware LLC statute states that the plaintiff in a derivative suit must be a member or assignee. The supreme court found the language of the Delaware LLC statute unambiguously limited derivative standing to members and assignees and thus affirmed the chancery court’s judgment. The court rejected the argument that the legislature intended to take the corporate rule of derivative standing for creditors of insolvent corporations and apply it to LLCs. Given the unambiguous language of the statute, the court stated that it “must apply the plain language without any extraneous contemplation of, or intellectually stimulating musings about, the General Assembly’s intent.” According to the court, applying the plain language did not yield an unreasonable or absurd result. The court found it logical for the General Assembly to limit derivative standing and exclude creditors given the contractual freedom provided to interested parties to define their relationships in the LLC context, which “affords creditors significant contractual flexibility to protect their unique, distinct interests.” The court also rejected the argument that the statutory limitation of derivative standing to members and assignees is an unconstitutional curtailment of the chancery court’s equitable jurisdiction. Based on the historical equity jurisdiction of the High Court of Chancery of Great Britain and the fact that LLCs did not exist at common law, the court concluded that the Delaware constitution only guarantees the chancery court’s jurisdiction to extend derivative standing to prevent failures of justice in cases involving corporations. When adjudicating the rights, remedies, and obligations associated with Delaware LLCs, the courts must look to the Delaware Limited Liability Company Act because it is the only statute that creates those rights, remedies, and obligations. Although the statute provides that common law principles of equity supplement the express provisions of the statute, courts cannot interpret the common law to override the express provisions the General Assembly adopted. “Supplementing express provisions is altogether different from displacing them or interpreting them out of existence under the guise of articulating and applying equitable principles.” In any event, the court concluded that there was no threat of a failure of justice that would justify application of equity even if the court had the jurisdiction to extend derivative standing (which the court emphatically stated that it did not). The court pointed out that the creditor here chose to lend on what later turned

out to be unfavorable terms. As examples of provisions that the creditor could have obtained to protect itself, the court stated that the creditor could have negotiated for a provision that would convert its interests to that of an assignee in the event of an insolvency or a provision that would give the creditor control of the LLC's governing body in an insolvency. The fact that the creditor did not craft its loan documents to adequately protect its legal remedies in the event of the LLC's insolvency did not amount to a threat to the interests of justice that would justify an equitable extension of derivative standing.

Claims for Wrongful Distribution Belong to LLC and Members Lack Standing to Assert

In re Whittle (White v. Whittle), 449 B.R. 427 (Bankr. M.D. Fla. 2011).

Persons owning 50% of the membership units of a Florida LLC sought a judgment against the LLC's manager for misappropriating \$650,000 of LLC funds and a finding that the judgment was nondischargeable. The court held that the claimants were not creditors of the debtor because the claims belonged to the LLC. The court relied upon the separate legal existence of an LLC, the fact that the statute provides that an LLC holds its property separate and apart from the property of the members, and the fact that the statute provides that a member's liability for receipt of a wrongful distribution is to the LLC. The court noted that the statute provides for a right of a member to bring a derivative action, but the plaintiffs had not availed themselves of the statutorily-specified process.

Interpretation of Operating Agreement; Authority to Make Capital Call and Liability for Failure to Satisfy Capital Call

Canyon Creek Development, LLC v. Fox, 263 P.3d 799 (Kan. App. 2011).

Fox was a 50% member in two LLCs of which Julian and Horn were the other members. Fox failed to satisfy capital calls made by Julian on behalf of the LLCs, and the LLCs filed this action for breach of contract. The trial court granted summary judgment in favor of the LLCs in the amount of the capital calls.

On appeal, Fox first argued that Julian had no authority to make capital calls to cover the LLC's debt service when Julian and Horn did not hold a majority interest in the LLCs because the operating agreement generally required a decision to make a capital call to be made by a majority of the members. However, the operating agreement provided that, notwithstanding the general requirement of majority member approval, members were required to contribute such additional capital as was required to pay debt service, insurance, and real estate taxes owed by the LLC. Julian held a management position, and the capital calls were made to remain current on real estate loans to the LLCs. Because Fox failed to raise a fact issue as to the amount of additional capital needed or the reasons for the capital calls, there was no factual dispute on this issue. Thus, the trial court was correct in concluding that it was unnecessary for Julian to consult with Fox before making a capital call to satisfy a current obligation on outstanding loans.

The court of appeals then turned to the more difficult issue of the proper remedy for Fox's breach. Fox argued that the trial court erred in holding him personally liable for the capital contribution rather than limiting the remedy to a reduction of his ownership interest as provided for in the operating agreements. The court examined default provisions of the Kansas LLC statute and the provisions of the operating agreement and reached the conclusion that in a case such as this,

where the operating agreements prohibited withdrawal from the ventures, subjecting an investor to personal liability for potentially endless capital calls to prop up a failing venture was neither contemplated by the parties nor envisioned by the LLC statutes. The statute insulates the members from liability for debts of the LLC and claims of third parties against the LLC, and the operating agreements of the LLCs also contained clauses limiting the personal liability of a member for debts or losses “beyond” the member’s capital contributions. With respect to capital contributions, the operating agreements contained separate provisions regarding the initial capitalization of the LLCs and later increases in capital. The court explained that the provisions of the operating agreements regarding initial contributions were consistent with the provisions of the Kansas statute contemplating that a contribution may consist of cash, property, services rendered, or a promissory note or other obligation to contribute cash or perform services since the operating agreements measured the initial capital contributions by their “net fair market value,” a concept that would not be necessary if initial contributions were limited to cash. On the other hand, the provisions of the operating agreements regarding later capital infusions required such contributions to be in cash unless the manager otherwise consented. The court stated that this made perfect sense in that a venture in need of additional resources to meet current obligations such as debt service would need cash for those purposes, and the court concluded that the statutes and operating agreements contemplated different remedies for defaults in the payment of initial capital contributions and additional capital calls. The court noted the statutory default rule that a member is obligated to perform any promise to contribute cash or property or perform services, even if a member is unable to perform, and that a member may be required at the option of the LLC to contribute an amount of cash equal to the agreed value of the contribution that has not been made. This option is available as a default rule under the statute in addition to any other rights the LLC may have against the noncontributing member under the operating agreement or other law. The operating agreements of the LLCs did not contain a contrary provision. However, the court pointed out that the provisions of the operating agreements regarding additional cash capital contributions specifically addressed the remedy available against a member who fails to make an additional contribution. In that case, the operating agreement specified the LLC’s remedy was to dilute the interest of the defaulting member to the extent the other members covered by making additional capital contributions. The court pointed out that the Kansas LLC statute provides that a member who breaches an operating agreement is subject to specified penalties and consequences, and the statute specifically permits an LLC operating agreement to provide for a number of remedies for failure to make a required contribution. Although the capital call provisions of the operating agreement did not state that reduction of a noncontributing member’s interest was the sole remedy, the provisions also did not state that additional remedies were available. The court found it significant that the remedy of damages, the most fundamental remedy for breach of contract, was conspicuously absent from the provisions of the operating agreement dealing with additional capital contributions. The court contrasted the provisions of the operating agreement regarding withdrawal, which provided that a member who attempted to improperly withdraw would be subject to an action for damages. Thus, the court concluded that the failure to include such a fundamental remedy as damages when a member fails to contribute additional capital was not an oversight but rather expressed a clear intent that damages are not recoverable from a member who fails to contribute additional capital after the venture is up and running.

Default Fiduciary Duties of Managers; Interpretation of Operating Agreement Provisions re Self-Dealing Transactions; Breach of Fiduciary Duty by Bad Faith Sham Auction; Reliance on Expert Advice Defense

Auriga Capital Corporation v. Gatz Properties, LLC, __ A.3d __, 2012 WL 361677 (Del. Ch. Jan. 27, 2012).

Minority members of an LLC that held a long-term lease on a golf course sued the LLC's manager and the individual ("Gatz") who controlled the manager. Gatz and his family had majority voting control over the LLC and owned the golf course leased to the LLC and subleased by the LLC to a golf management corporation. When it became apparent that the golf management corporation would not renew the sublease, the LLC's manager did not take any steps to find a new strategic option that would protect the LLC's investors. Rather, the manager eventually conducted a sham auction to sell the LLC at which Gatz, on behalf of the manager, was the only bidder. The manager acquired the LLC at a nominal amount over the debt and then merged the LLC into the manager. Minority members of the LLC sued the manager and Gatz for breach of their contractual and fiduciary duties to the LLC and the minority members based on actions designed to squeeze out the minority members and deliver the LLC to the Gatz family on unfair terms. The court rejected the manager's claims that the operating agreement displaced the traditional fiduciary duties of the manager, that Gatz and his family were able to exercise their voting rights as members to veto any option for the LLC and thus properly use a "chokehold" over the LLC to pursue their own interests, and that the LLC was valueless by the time of the auction.

The court first discussed at some length the principle that managers of a Delaware LLC owe traditional fiduciary duties of loyalty and care as a default rule. The court based this conclusion on the explicit equitable overlay provided by the LLC statute (Section 18-1104 provides that "[i]n any case not provided for" by the statute, "the rules of law and equity...govern"), the manner in which the statute addresses contractual modification of fiduciary duties (Section 18-1101 permits an LLC agreement to expand, restrict, or eliminate fiduciary duties), existing case law, and problems that would arise if the equitable backdrop contained in the statute were to be judicially excised (disruption of expectations of those who crafted LLC agreements in reliance on equitable defaults that supply a predictable basis for assessing whether a business fiduciary has met its obligations and erosion of Delaware's credibility with investors in Delaware entities).

After explaining that an LLC manager owes traditional fiduciary duties of care and loyalty absent contractual provisions altering the duties, the court turned to the provisions of the LLC agreement in this case and concluded that the agreement did not displace the traditional fiduciary duties of care and loyalty. The court interpreted a provision addressing agreements with affiliates as distilling the duty to prove fairness of a self-dealing transaction to its economic essence (i.e., requiring a showing of fair price) but not otherwise affecting the analysis of the manager's conduct giving rise to the dispute. The provision placed the burden on the manager to show that the price term of an affiliate agreement was the equivalent of one in an arms-length agreement, and the court found that the manager failed to meet that burden because there was no effort to determine the price at which a transaction could be effected through a deal with a third party. The court also addressed an indemnification and exculpation provision that the court noted was both stronger and weaker than a charter provision authorized by Section 102(b)(7) of the Delaware General Corporation Law in that the provision at issue preserved liability for a breach of the duty of care (gross negligence) but

provided exculpation for a breach of the duty of loyalty to the extent the breach was not committed in bad faith or through willful misconduct. Under the exculpation provision of the LLC agreement, Gatz and the manager had no monetary liability for a good faith breach of default fiduciary duties unless the breach was the result of gross negligence, willful misconduct, or willful misrepresentation. Also, the conduct must be on behalf of the LLC and reasonably believed to be within the scope of authority conferred by the agreement. The court found that the provision did not protect the defendants because the auction and follow-on merger were effected in violation of the arms-length mandate of the LLC agreement and thus not authorized by the LLC agreement. Additionally, the court concluded that the exculpation provision did not apply even if it exculpated conduct in violation of the arms-length provision because the court found that the actions related to the auction and merger were taken in bad faith.

The court described in detail how Gatz and the manager breached their fiduciary duties of loyalty and care by (1) failing to explore strategic options for the LLC for several years after it became clear that the golf course management corporation would not renew its sublease, (2) rebuffing a credible buyer of the LLC's long-term lease, (3) taking advantage of the economic vulnerability of the LLC created by their own loyalty breaches to play "hardball" with the minority members by making unfair buy-out offers on the basis of misleading disclosures, and (4) conducting a sham auction that delivered the LLC to the manager for a bid of \$50,000 in excess of the LLC's debt (of which the manager was already a guarantor). As a result of this conduct, the Gatz family re-acquired fee simple ownership of the property, on which the LLC had spent millions of dollars to build a first-rate Robert Trent Jones, Jr.-designed golf course and clubhouse, and the minority members received only \$21,000. The court rejected the manager's defense that the voting power held as a member gave it license to exploit the minority. The court acknowledged that the manager was free not to vote its interest for a sale, but the manager was not free to create a situation of economic distress by failing to explore the LLC's market alternatives and then to buy the LLC for a nominal price. The court also rejected the manager's argument that the LLC was worth less than its debt and that thus any surplus over zero was a fair price. The court could not accept this proposition as true on the record before it and stated that the evidence suggested that the LLC was worth more than the manager paid. The lack of concrete evidence of the LLC's value was the fault of the defendants, who fended off a credible third-party purchaser of the leasehold and conducted an unfair auction, and such ambiguities are construed against the self-conflicted fiduciaries who create them. In the course of discussing the flaws in the auction, the court noted that the manager was not protected by the auctioneer's expert advice under Section 18-406 of the LLC statute. The court stated that a fiduciary cannot select an unqualified advisor and then claim it was guided by an expert. Furthermore, the manager's reliance claim was undercut by its full involvement in the development and approval of the marketing plan and terms of sale.

The defendants argued that there should be no damages award because the LLC was insolvent at the time of the sale. The court was not convinced that the golf course had no positive value and pointed to several indicators that the property justified a bid above the debt owed. The most important factor to the court, however, was that the defendants themselves were responsible for the evidentiary uncertainty by their selfishly motivated acts of mismanagement. The manager had no duty to sell its interest but was not free to mismanage the LLC so as to deliver the LLC to itself for an unfair price. The court awarded the minority members the full amount of their capital contributions plus an additional amount, which totaled to slightly less than what would have been

produced by a sale in 2007 at \$6.5 million (there being evidence that if the defendants wanted to buy the LLC in 2007, they would have had to pay a price in excess of \$6 million). The court characterized its award as a “modest remedy” and stated that the record could support a higher amount. The court also concluded that a partial fee shifting was warranted and awarded the minority members half their attorney’s fees and costs based on the bad faith exception to the American Rule.

Interpretation of Operating Agreement; Restriction or Elimination of Fiduciary Duties; Effect of Contractual Disclaimer on Breach of Fiduciary Duty and Fraud Claims in Connection with Transfer of LLC Interest

Pappas v. Tzolis, 932 N.Y.S.2d 439 (App. Div. Dept. 1 2011).

Tzolis, the defendant, and Pappas and Infantopoulos, the plaintiffs, formed a Delaware LLC for the purpose of entering into a long-term lease on a building. About eight months after the lease commenced, Tzolis suggested to the plaintiffs that they assign their interests in the LLC to Tzolis for 20 times what they had invested one year earlier. The plaintiffs agreed and negotiated buyouts to become effective on a later date if certain events occurred. Pappas, a 40% member, was to receive \$1,000,000, and Infantopoulos, a 20% member, was to receive \$500,000 for his interest. In addition to the assignment agreement, the plaintiffs signed a handwritten certificate stating that each of the plaintiffs performed their own due diligence in connection with the assignments, engaged their own legal counsel, and did not rely on any representation by Tzolis or his representatives. The plaintiffs further acknowledged in the certificate that Tzolis owed them no fiduciary duty in connection with the assignments. The operating agreement also contained a provision stating that a member could engage in other business ventures of any nature, whether or not in competition with the LLC, without any obligation to the LLC or its members. The assignments became effective, and six months later the LLC (wholly owned at this time by Tzolis) assigned its lease to another entity for \$17.5 million. Pappas claimed that he later discovered Tzolis had begun negotiating the sale of the lease months before the assignment of the plaintiffs’ interests. The plaintiffs asserted numerous causes of action, and Tzolis moved to dismiss the complaint in its entirety. Tzolis argued that he and the plaintiffs never intended to enter into a fiduciary relationship and that Delaware law permitted the elimination of fiduciary duties among members, which was achieved by the paragraph in the operating agreement permitting members to pursue other business opportunities. Tzolis also relied upon the certificate signed by the plaintiffs. The motion court concluded that the operating agreement eliminated the fiduciary relationship that would have otherwise existed among the members and granted the motion to dismiss. The appellate court disagreed with the lower court’s interpretation of the operating agreement and reinstated a number of the plaintiffs’ claims. The court stated that the operating agreement may have permitted Tzolis to pursue a business opportunity unrelated to the LLC for his exclusive benefit without having to disclose it to the plaintiffs or present it to the LLC, but the clause did not permit the behavior here, which was to surreptitiously engineer the lucrative sale of the LLC’s sole asset without informing his fellow members. The court stated that the agreement did not eliminate all fiduciary duties that the parties owed one another because managers owe traditional fiduciary duties under Delaware law unless the LLC agreement explicitly restricts or eliminates those duties. The court concluded that the plaintiffs adequately alleged that Tzolis breached a fiduciary duty to keep them informed of any and all opportunities he was pursuing on behalf of the LLC. With respect to the certificate, the court relied upon *Blue Chip Emerald v. Allied Partners*, in which the

court stated that “a fiduciary cannot by contract relieve itself of the fiduciary obligation of full disclosure by withholding the very information the beneficiary needs in order to make a reasoned judgment whether to agree to the proposed contract.” Accordingly, the court here concluded that the motion court erred in dismissing the plaintiffs’ claims for breach of fiduciary duty and fraud. The court also reinstated the plaintiffs’ claims for conversion and unjust enrichment. The dismissal of a claim for misappropriation of business opportunity by Tzolis was upheld because it was the LLC that assigned the lease, and the court held that claims based on or related to breach of contract were properly dismissed. Because the plaintiffs’ assignment of their interests might be voidable, the court held that the plaintiffs had standing to assert a derivative claim on behalf of the LLC, but the derivative claim for breach of fiduciary duty to the LLC was properly dismissed because the allegations showed that the LLC received \$17.5 million for the lease.

Two justices dissented on the basis that the contractual disclaimers by the plaintiffs precluded the causes of action asserted. The dissent argued that the majority’s reliance on *Blue Chip Emerald v. Alliance Partners* was misplaced and that the disclaimers in the certificate effectively released the plaintiffs’ claim for breach of fiduciary duty based on *Centro Empresarial Cempresa S.A. v. America Movil*, a case in which the New York Court of Appeals held that the broad release signed by the minority shareholders of a closely held corporation was effective to release breach of fiduciary duty, fraud, and unjust enrichment claims. The dissent argued that the fraud claim failed under New York’s “special facts” doctrine, which imposes a duty to disclose absent a fiduciary duty only where one party’s superior knowledge is such that nondisclosure would render the transaction unfair. According to the dissent, the offer to buy their interests for 20 times what the plaintiffs invested should have alerted them to the fact that a deal was in the offing, and their failure to investigate was unreasonable as a matter of law and fatal to their claim.

Business Judgment Rule; Ratification; Reliance on Counsel Defense; Participation of LLC in Derivative Suit

Sutherland v. Sutherland, 348 S.W.3d 84 (Mo. App. 2011).

The plaintiff member of an LLC in an unsuccessful derivative suit against the managers and related parties complained on appeal that the jury instruction on the business judgment rule did not accurately state the rule. The instruction stated: “A fiduciary is presumed to have discharged his duties with due care and good faith and in the honest belief that he was acting in the best interests of the limited liability company, absent a showing that he put his personal interests ahead of the interests of the limited liability company.” The court of appeals described the business judgment rule as protecting directors and officers of a corporation from liability for *intra vires* decisions within their authority made in good faith, uninfluenced by any consideration other than the honest belief that the action serves the best interests of the corporation. The court stated that the rule as applicable to LLCs has been codified in the Missouri LLC statute, which the court stated provides that LLC directors and officers shall not be liable for business decisions that they believe in good faith are in the best interests of the LLC. The plaintiff argued that the instruction was erroneous because it did not contain an instruction that the burden shifts in an equitable action to recover profits where it has been established that the director or officer had an interest in the transaction. The court stated that it had found no case law indicating that a business-judgment-rule instruction cannot be given without also instructing that the burden may shift in an equitable action to recover profits, and the plaintiff

failed to demonstrate any prejudice. Further, the court pointed to separate instructions given on breach of fiduciary duty as to each of the managers, and the court stated that the jury would have found a breach of fiduciary duty if the evidence established the managers put a personal interest before the LLC. The court stated that the plaintiff's real complaint seemed to revolve around the failure of the court to give a proposed instruction that "[a] fiduciary puts his personal interest before the interest of the company when an entity in which he has an interest engages in a transaction with the company." The court concluded that this sentence misstates the law in that it describes an irrebuttable presumption any time a fiduciary engages in a transaction with the company, rather than a rebuttable presumption as described by case law. The court also noted that the Missouri LLC statute provides that a member or manager may transact business with the LLC and, subject to other law, has the same rights and obligations in the transaction as a person who is not a member or manager. The court viewed this as a determination by the Missouri legislature that there is nothing inherently insidious about a manager doing business with the LLC.

The plaintiff next complained that the trial court erred in instructing the jury on the doctrine of ratification. The plaintiff argued that Missouri law does not permit the members of an LLC to retrospectively ratify acts or transactions of its managers. The court rejected this argument based on language in the Missouri LLC statute, which provides that the act of a member or manager which is not apparently for carrying on in the usual way the business of the LLC does not bind the LLC unless authorized in accordance with the terms of the operating agreement, "at the time of the transaction *or at any other time.*"

The plaintiff complained that an instruction setting forth the defense of reliance on counsel was erroneous because it failed to require proof that the defendants had fully disclosed all of the material facts to counsel in obtaining the advice. The court concluded that the instruction substantially reflected the elements of the defense set forth in the Missouri LLC statute and that the instruction implicitly included the requirement of disclosure of the material facts by requiring the jury to find that the defendants "reasonably relied" upon the advice received. The court also reviewed the evidence supporting the defense of reliance on advice of counsel and found the record supported the jury's finding in favor of the defendants.

Finally, the plaintiff complained that the trial court erred in allowing the LLC to participate to any extent in the trial. The court held that the plaintiff failed to preserve this issue for appeal, but the court went on to explain that the trial court did not err in any event. The court noted the general rule that a corporation cannot participate in the defense on the merits of a derivative action unless the derivative action threatens rather than advances the corporate interests. The court stated that a specific example of a situation where the interests of the corporation are threatened is where an action attempts to interfere with internal management and there is no allegation of fraud or bad faith. Here, the plaintiff challenged the process by which the owners of the LLC ratified the decisions of management, and the trial court limited the LLC's participation to that issue, allowing the LLC to defend its management process. The trial court's order did not allow the LLC's counsel to make any comments or remarks regarding the claims made against the LLC's management. Thus, the court held that the trial court did not abuse its discretion in crafting a ruling that allowed the LLC to defend its management process while requiring the LLC to remain neutral in other respects.

Fiduciary Duty of Non-Member/Non-Manager Agent of LLC

Western Blue Print Company, LLC v. Roberts, __ S.W.3d __, 2011 WL 1597954 (Mo. App. 2011).

An LLC hired Roberts to set up and run a branch office, and Roberts was promoted from branch manager to division vice-president. Based on actions taken by Roberts while she was employed by the LLC, it sued Roberts for breach of fiduciary duty and other claims. Roberts challenged the existence of a fiduciary duty on her part. The court explained that the concepts of a “fiduciary duty” and a “duty of loyalty” are distinct in the context of an employer-employee relationship. A fiduciary duty includes the duty of loyalty but requires more. In short, the court said that the duty of loyalty prevents an employee from competing with the employer while the employment relationship exists; a fiduciary duty requires the agent to be honest and faithful to the principal in all respects related to the agency. The court stated that an employee’s duty of loyalty in Missouri is well-defined, but case law has left open the question of whether and to what extent an employee owes an employer a fiduciary duty. The court stated that agents owe their principals a fiduciary duty, but the employer-employee relationship does not without more create a fiduciary relationship beyond the duty of loyalty. The court adopted the position that not all employees owe their employers a fiduciary duty, but a fiduciary duty is owed by an employee to whom the employer has entrusted confidence and control over a significant portion of the employer’s affairs. The court concluded that Roberts had been entrusted with confidence and control over a significant portion of the LLC’s business affairs and thus owed a fiduciary duty to the LLC. Roberts argued that the LLC could only be owed a fiduciary duty by a member or manager and that she held no such position. The court acknowledged that members and managers of an LLC owe a statutory duty to the LLC but stated that the fact that the LLC statute imposes duties on managers and members does not mean that traditional common-law duties owed by agents cease to exist when the principal is an LLC. The court saw no reason why an agent’s fiduciary duty should depend on the organizational character of the principal.

Authority of Manager or Member

Simmons v. Ball, 68 So.3d 831 (Ala. 2011).

Brothers Andy and Mike Ball formed an LLC to flip houses. The articles of organization placed the business and affairs “under the managerial control of the member: Andy Ball.” Other provisions of the articles of organization assumed that Andy was the manager and further referred to his authority as a member but did not explicitly identify Andy as a manager. The operating agreement named Andy as the manager, registered agent, and organizer of the LLC. After a disagreement between Andy and Mike, Andy “disappeared” for several weeks, and Mike, acting on advice of his lawyers, attempted to preserve the LLC’s assets by transferring the LLC’s property into his name. Mike executed and recorded deeds purporting to transfer to himself the real property owned by the LLC. Mike filed a suit to dissolve the LLC, and the court ordered that the LLC’s assets be placed back in the LLC name and transferred only by court order, with the proceeds to be held in escrow pending instructions by the court. Mike and Andy agreed that deeds conveying back to the LLC the property Mike had attempted to transfer to himself would be signed but not recorded until third-party purchasers were located and court approval for the sale was obtained. A copy of

one of the deeds signed by Mike to the LLC was given to Andy's lawyer, and Andy recorded the copy. Simmons then loaned the LLC money and received from Andy a mortgage on the property covered by the copy of the deed that was recorded. When the LLC defaulted on the loan, Simmons sought to foreclose on the mortgaged property, and Mike sought to enjoin the foreclosure. The trial court concluded that the conspicuous designation "COPY" on the deed recorded by Andy was sufficient to put Simmons on inquiry notice as to why the original deed was not recorded. The dispositive issue addressed by the court in this opinion was the effectiveness of the deed Mike executed transferring the property from the LLC to Mike after Andy became inactive in the LLC. The court relied upon the clear language of the statute that no member is an agent of the LLC when a manager has been appointed by the articles of organization. The statute further specifically provides that a member, acting as a member, has no authority to transfer property of the LLC if the articles of organization provide that management of the LLC is vested in a manager or managers. Because the LLC's articles of organization appointed Andy as manager and Mike was only a member, Mike had no authority to transfer the LLC's property to himself. The court analyzed whether the deed from the LLC to Mike was voidable at the LLC's option or simply void, having no legal effect on the title to the property at issue. The court stated that the statutory provisions indicate an intent to protect third parties as well as the LLC, and the court concluded that a transaction by a member in contravention of the authority vested in a manager by the LLC's articles of organization is void. Thus, Mike's transfer of title of the LLC's property to himself was void, and Simmons received title to the property at issue by the mortgage from the LLC executed by Andy regardless of whether Simmons had notice of previous transactions regarding the property.

In re Northlake Development, LLC (Kinwood Capital Group, L.L.C. v. BankPlus), 60 So.3d 792 (Miss. 2011).

The Mississippi Supreme Court determined on a certified question from the Fifth Circuit Court of Appeals that a deed executed by a minority member of an LLC without actual or apparent authority was void rather than merely voidable. A lender who obtained a deed of trust from the purported grantee of the LLC, in good faith and without notice that the deed from the LLC was unauthorized, argued that the deed from the LLC was merely voidable and that the deed of trust was thus enforceable. The certified question presented was: "When a minority member of a Mississippi limited liability company prepares and executes, on behalf of the LLC, a deed to substantially all of the LLC's real estate, in favor of another LLC of which the same individual is the sole owner, without authority to do so under the first LLC's operating agreement, is the transfer of real property pursuant to the deed: (i) voidable, such that it is subject to intervening rights of a subsequent bonafide purchaser for value and without notice, or (ii) void *ab initio*, i.e., a legal nullity?" It was undisputed that the minority member lacked actual authority to transfer the property because the operating agreement required the affirmative vote of members holding at least 75% of the membership to approve the transfer of all of the LLC's assets other than in the ordinary course of business. The court thus turned to the question of apparent authority. The court noted the agency provisions of the Mississippi LLC statute applicable to the case (the provisions of the Revised Mississippi Limited Liability Company Act did not apply because the LLCs were formed before January 1, 2011), and the court stated that, under the statute, the minority member was an agent of the LLC for the purpose of conducting the business and affairs of the LLC in the "usual way." The court noted that an agent generally cannot bind a principal to a contract unless the principal clothes

the agent with actual or apparent authority. The minority member knew he had no actual authority to transfer the property, and his knowledge was imputed to his LLC that was the grantee under the deed executed by the minority member. Because the doctrine of apparent authority is unavailable to one who knows an agent lacks authority, the court concluded that the minority member had no apparent authority to transfer the property to his wholly owned LLC. The certified question asked whether the unauthorized conveyance was voidable, i.e., was it an effective transfer unless and until the LLC repudiated it? The court stated that it is settled Mississippi law that an agent is powerless to affect the legal relationship between the principal and others absent some form of legal authority. The court recognized that Mississippi law allows a principal to ratify an agent's unauthorized act, and the court relied upon the Restatement (Third) of Agency for a description and explanation of the concept of ratification. The court held that a deed executed without actual or apparent authority is void unless and until later ratified. Here, there was no ratification, and the deed was void. There was no need for the LLC to repudiate the unauthorized deed. Once the LLC learned of the purported conveyance, it could have ratified it, but it did not, and the LLC's rights were thus not affected by the deed.

Synectic Ventures I, LLC v. EVI Corporation, 251 P.3d 216 (Or. App. 2011).

Three LLC venture capital funds that made a loan to the defendant argued that the manager of the LLCs lacked authority to bind the LLCs to an amendment to the loan agreement extending the time of payment. The manager of the LLCs also served as board chairman, treasurer, and fundraiser for the borrower. The LLCs argued that the manager lacked authority to amend the loan agreement based on limitations in letter agreements entered into by the manager with certain investors or, alternatively, because the manager breached duties to the LLC by executing the amendment.

The court reviewed provisions of the Oregon LLC statute regarding a manager's authority, provisions of the LLC operating agreements, provisions of the letter agreements, and common-law agency principles and concluded that the manager had actual authority to bind the LLCs to the amendment to the loan agreement. The Oregon statute provides that a manager is an agent of the LLC for the purpose of its business and that an act of the manager for apparently carrying on in the ordinary course the business of the LLC binds the LLC unless the manager lacks authority and the third party knew or had notice that the manager lacked authority. The operating agreements conferred the authority to manage and control the LLC exclusively on the manager and granted any third party the right to rely on the manager's authority without further inquiry. The LLCs argued that the manager lacked authority to amend the loan agreement because concerned investors who had investigated the manager's management of the funds had secured the agreement of the manager in certain letter agreements that the manager would not incur new obligations on behalf of the funds or increase any current obligations without the approval of the concerned investors. The court concluded that the letter agreements did not limit the manager's authority to bind the LLCs to the amendment because the agreements were with a group of individual investors in the LLCs rather than the LLCs themselves. Further, the court pointed out provisions of the letter agreements and email correspondence indicating that the letter agreements did not limit the authority of the manager to act on behalf of the LLCs. The operating agreements contained a specified procedure for removal of the manager that was eventually followed, but not before the amendment was executed, and the letter agreements were ineffective to limit the manager's authority because they did not comply with the process for removal of the manager. The court acknowledged that the letter agreements may

have created obligations of the manager to the concerned investors, but any breach of those obligations was between them and did not affect his authority to conduct business on the LLCs' behalf.

The LLCs also argued that they were not bound by the amendment to the loan agreement because the manager breached his statutory and contractual duties of loyalty, care, and good faith. The court analyzed Oregon case law relied upon by the LLCs for the proposition that an agent cannot bind his principal in a matter in which his own interest conflicts with his duty to the principal, particularly when the third party knew that the agent was breaching his duties. The court concluded that the breach of fiduciary duty in the cases relied upon by the LLCs did not act to sever or limit the agent's authority in those cases; the cases stood only for the "unremarkable proposition that, if a third party is aware that the agent is engaged in self-dealing in the transaction, the third party must inquire into the agent's actual authority." Since the court determined that the manager retained the express authority under the operating agreement to enter into the amendment, any inquiry based on knowledge by the borrower of the manager's self-dealing (which the LLCs argued was imputed to the borrower since the manager was an officer of the borrower) could only lead to the conclusion that the manager was authorized. The LLCs raised related, but distinct conflict-of-interest issues, based on the provisions of the LLC statute requiring majority member approval of a conflict-of-interest transaction. The court pointed out that the statutory requirement applies unless the operating agreement provides otherwise, and the operating agreement of the LLCs contained a provision permitting any member or its affiliates to engage in other businesses and investments without any duty to account and to own securities issued by or participate in the management of companies in which the LLCs may invest. These provisions further stated that the other members and LLCs would have no claim or cause of action arising from such ownership or participation. The court concluded that the type of conflict alleged was authorized and that the statutory approval provision did not apply.

Farm & Ranch Services, Ltd. v. LT Farm & Ranch, LLC, 779 F.Supp.2d 949 (S.D. Iowa 2011).

In 1998, Lee and Tripp formed an LLC of which Lee was initially designated by the operating agreement as sole manager with broad powers. The LLC acquired farm land enrolled in the Conservation Reserve Program (CRP) of the Commodity Credit Corporation. In 2000, the operating agreement was amended to make Lee and Tripp co-managers. At issue in this case were contracts entered into by Lee on behalf of the LLC relating to CRP payments. The court discussed agency principles as they applied to an Iowa LLC under the Iowa LLC statute in effect before the adoption of the Revised Uniform Limited Liability Company Act since the dispute predated adoption of the revised law. The court discussed the concepts of actual and apparent authority and stated that it was undisputed that Lee was an agent of the LLC as a manager, first as the LLC's sole manager and thereafter as a co-manager. As such, he had actual authority as conferred in the operating agreement. In addition, Lee had apparent authority. The court stated that the LLC, by the operating agreement, knowingly permitted Lee to act as the manager and held out Lee as possessing the ordinary authority of a farm manager. The court also noted that the LLC statute provides that the act of any manager with agency authority for apparently carrying on in the ordinary course of the business or affairs of the LLC binds the LLC unless the manager lacks authority and the party dealing with the manager has knowledge of the lack of authority. The court characterized the statutory provisions as consistent

with general principles of apparent authority in agency law. Thus, the court stated that a manager has apparent authority to act for the LLC in matters in the ordinary course of business unless the third person has actual knowledge that the manager does not have authority to act. The court stated that a third party does not have to verify the manager's authority as to matters in the ordinary course and is not charged with knowledge of limitations in organizational documents. "Were it otherwise, third parties would be reluctant to deal with an LLC," according to the court. Although the Revised Uniform Limited Liability Company Act recently enacted in Iowa did not apply to this case, the court stated that "[t]his principle of a manager's apparent authority appears to have been carried forward in the Revised Uniform Limited Liability Company Act now largely in effect in Iowa." The court noted the Act's comments, which state that courts may view the position of an LLC manager as clothing the person with apparent authority to take actions that reasonably appear within the ordinary course of the LLC's business and which state that the nature of an LLC's business is relevant to whether a third party could reasonably believe that a manager is authorized in the transaction. While sole manager, Lee had authority to take action to re-enroll the LLC's farms in the CRP. The question was Lee's authority later when he was co-manager to sell a substantial part of the CRP entitlement. Iowa law at the time provided that manager decisions required a majority vote of the managers. Tripp was not consulted by Lee, and the third party did not know Lee lacked authority. The court concluded that the third party could reasonably believe that Lee as manager of the LLC had authority to sell the CRP payments and that the transaction was not so extraordinary as to call his apparent authority into question. The court also discussed the principle of ratification and concluded that the LLC had ratified the contracts at issue by accepting the benefits (though Lee would later misappropriate for himself the payments received in the transaction) and failing to object for three years. The court stated that the benefits were "knowingly" accepted by virtue of the knowledge of Lee, whose knowledge as an agent is imputed to the principal. Even though Lee was acting adversely to the LLC by scheming to defraud the LLC and Tripp, the court concluded his knowledge was imputed because it was necessary to protect the rights of the third party who acted in good faith. Further, the court found it entirely appropriate that the LLC and Tripp should bear the consequences of Lee's conduct where Tripp abdicated the management of the LLC to Lee and failed to take even the most basic precautions to ensure that it was being appropriately managed. The court characterized Tripp's inattention as breaching his own fiduciary responsibility and as contributing to Lee's malfeasance.

Interpretation of Operating Agreement; Effect of Assignment and Restrictions on Transfer of Membership Interest

Ott v. Monroe, 719 S.E2d 309 (Va. 2011).

Dewey and Lou Ann Monroe formed a Virginia LLC of which Dewey was an 80% member and Lou Ann was a 20% member. Dewey died and bequeathed his entire estate to his daughter, Janet. Janet claimed that she inherited her father's membership in the LLC, but Lou Ann argued that Janet inherited only Dewey's right to share in the profits and losses of the LLC and to receive distributions to which Dewey would have been entitled. Paragraph 2 of the operating agreement prohibited a member from transferring his membership or ownership, or any portion thereof, to any non-member without the written consent of all other members except by death, intestacy, devise, or otherwise by operation of law. Paragraph 10(B) of the operating agreement prohibited the transfer

of all or any part of a member's membership interest other than as provided by the operating agreement. Paragraph 10(C) of the operating agreement stated that, notwithstanding Paragraph 10(B), a member may transfer any portion of the member's interest at any time to other members or the spouse, children, or other descendants of the member. The court prefaced its discussion of the specific dispute in this case with a discussion of the background of the Virginia Limited Liability Company Act and the nature of an LLC and explained how the treatment of a membership interest in an LLC is similar to that of a partnership interest, i.e., the interest is divided into a control interest that may not be unilaterally transferred and a financial interest that is assignable. Janet argued that she inherited Dewey's membership by operation of his will because Paragraph 2 of the operating agreement permitted her to inherit it. However, the court stated that Paragraph 2 merely prohibited a member from transferring any part of his membership except where specifically allowed under the terms of the agreement, with consent of all other members, or upon death, intestacy, devise, or otherwise by operation of law. The court stated that the provision did not address statutory dissociation and did not specifically state an intent to supersede the provision of the statute making death a dissociation except as otherwise provided by the operating agreement. Thus, the court concluded that Dewey was dissociated from the LLC upon his death, and Janet became a mere assignee entitled only to his financial interest. The court went on to opine that it is not possible for a member to unilaterally alienate his control interest even if the operating agreement purports to allow it. The court stated that the words "unless otherwise provided in the articles of organization or an operating agreement" make it possible for an LLC to restrict assignment of members' financial interests because they modify the remainder of the sentence in the statute, which states that a membership interest is assignable in whole or in part. According to the court, the proviso does not make it possible for an LLC to allow a member to assign his control interest because the proviso does not modify the separate sentence stating that an assignment does not entitle an assignee to participate in the management and affairs of the LLC or to become or exercise any rights of a member. Additionally, the statute provides that an operating agreement may not contain provisions inconsistent with Virginia laws. Thus, the court concluded that it was not within Dewey's power under the agreement to unilaterally convey to Janet his control interest and make her a member because the agreement could not confer on him that power.

Condo v. Connors, 266 P.3d 1110 (Colo. 2011).

As part of a divorce settlement, a one-third member of an LLC assigned to his wife his right to receive monetary distributions and agreed that he would vote against all matters requiring unanimous consent unless his wife directed him to do otherwise. The operating agreement of the LLC contained provisions prohibiting assignment of any portion of a member's interest and stating that a member who wished to dispose of any part of the member's interest must first obtain written approval of all members. The couple sought approval of the other members, but they refused to approve of the transfer. The couple went ahead with the assignment and submitted it to the divorce court without any reference to the operating agreement or consent of the other members. When the other members learned of the assignment, they expressed to the husband their concern that it violated the terms of the operating agreement and their unease that the assignment would effectively make the husband a noncontributing member and eliminate any incentive he had to assist in the LLC's continued financial success. To resolve these concerns, the other two members offered to buy the husband's interest, and the husband agreed to sell it to the other two members. The wife brought suit

against the members for tortious interference with contract and civil conspiracy. The trial court granted summary judgment in favor of the members on the basis that the assignment from the husband to the wife was void, and the court of appeals affirmed. The supreme court likewise affirmed, but each court employed different reasoning in reaching the conclusion that the husband's assignment to the wife was void. The trial court found that the assignment was void as against public policy because the husband's failure to obtain the consent of the other members constituted bad faith in corporate dealings. The court of appeals concluded that the assignment was void because the operating agreement, interpreted in light of general principles of contract law, prevented the assignment of the right to distributions without consent of all members and thus rendered the assignment void. The court of appeals further held that the dispute was governed by what it believed was the supreme court's adoption of the "classical approach" to anti-assignment clauses in a 1994 opinion. The supreme court's analysis and reasoning was similar to that of the court of appeals, but the supreme court clarified that the opinion relied upon by the court of appeals was not a blanket rejection of the modern approach in favor of the classical approach to assignments.

In its analysis, the supreme court addressed as a threshold matter the defendants' argument that the operating agreement, because it serves as an organic document for the LLC, more closely resembles a constitution or charter than a contract and should not be interpreted in accordance with contract law. The members argued that the operating agreement serves as a "super-contract" explicitly restricting the power of a member to transfer any interest without complying with the operating agreement and that any potential exception found in contract law is irrelevant. The supreme court disagreed and held that an LLC operating agreement is a multilateral contract among the members and that it is appropriate to interpret it in light of prevailing principles of contract law.

The court examined the provisions of the operating agreement and rejected two alternative arguments advanced by the wife as to why the unapproved assignment to her was effective. First, the wife argued that the assignment did not violate the anti-assignment clause because it should be narrowly interpreted to prohibit only nonconforming assignments of contractual duties. She claimed that the provision did not apply to her husband's right to receive monetary distributions. The court did not read the provision so narrowly. The court noted that the Colorado LLC statute compelled the court to give "maximum effect" to the terms of the operating agreement. The operating agreement stated that a member shall not transfer "any portion of its interest" in the LLC without prior written approval of all members. Under the Colorado LLC statute, a membership interest in the LLC is defined to include the right to receive distributions of the LLC's assets. The operating agreement further set forth the manner and timing of mandatory distributions, thus creating an enforceable right on the part of members. The court stated that the express limitation on transfer of "any portion" appeared to employ the broadest possible language, unlike sample language in treatises cited by the wife. Thus, like the court of appeals, the supreme court concluded that the right to receive distributions fell within the scope of the anti-assignment clause because the clause applied to "any portion" of the membership interest.

Having determined that the anti-assignment clause in the operating agreement applied to the transfer of both rights and duties, the supreme court addressed whether the unapproved assignment was without any legal effect, i.e., void, or whether the husband had the power but not the right to make the assignment, i.e., the assignment was effective but constituted a breach of the operating agreement. The court again noted that the Colorado LLC statute requires that "maximum effect" be given to the terms of an operating agreement, but the court stated that giving "maximum effect" to

the anti-assignment clause did not resolve whether it functioned as a duty not to assign without consent or rendered each member powerless to assign without consent. The court turned to an examination of the classical and modern approaches to anti-assignment clauses to resolve this question. Relying on Colorado case law and the Restatement (Second) of Contracts, the court concluded that the language of the operating agreement and context of the dispute rendered the husband powerless to make the unapproved assignment. The wife urged that the court should apply the modern approach to the anti-assignment clause, under which a prohibition on assignment is treated as a contractual obligation but does not restrict the power to make a nonconforming assignment unless the clause expressly states that a nonconforming assignment is “void” or “invalid.” The court pointed out that the Restatement does not adopt the strict “magic words” approach but instead looks to the language used and the context in which the contract is made to determine whether an anti-assignment clause merely creates a duty not to assign. The court discussed its previous application of the classical approach in *Parrish Chiropractic Centers, P.C. v. Progressive Casualty Insurance Co.*, 874 P.2d 1049 (Colo. 1994) and found two of the rationales employed in that case pertinent to the resolution of this case. These two rationales were the strong public policy in favor of freedom of contract and the right of the non-assigning party to deal only with whom it contracted. The court rejected the wife’s argument that the strict “magic words” approach provides the best public policy and that other legislative enactments in Colorado evinced a clear preference for free assignability. The court explained, however, that *Parrish Chiropractic* was not a blanket rejection of the modern approach to assignments as the court of appeals had understood it to be. Rather, the supreme court stated that it was “narrowly” holding that the strict “magic words” approach was inapplicable in this case based on the circumstances and terms of the operating agreement. Although the court stated that the statutory directive to give “maximum effect” to the terms of the operating agreement did not resolve the effect of the assignment, it did reflect a legislative preference for freedom of contract over free alienability of membership rights. Thus, in light of the strong public policy in favor of freedom of contract, the court found that the plain language of the operating agreement rendered the husband powerless to make the unapproved assignment. Further, the court noted a clear public policy of allowing the members of a closely held LLC to tightly control who may receive either rights or duties under the operating agreement.

A concurring opinion argued that the statutory directive to give “maximum effect” to the terms of the operating agreement was controlling. According to the concurring justices, giving “maximum effect” to the operating agreement meant that the unapproved assignment was void *ab initio* and left no room for arguments such as the wife’s that the member had the power to make an assignment and merely opened himself up to a breach-of-contract action. The concurring justices were troubled by the majority’s approach that the determination of whether an assignor has the power to make an assignment in violation of an anti-assignment clause is dependent upon the circumstances and is thus an issue to be determined on a case-by-case basis. According to the concurring opinion, “the majority’s opinion leaves LLC law unsettled and open to uncertainty.”

Interpretation of Operating Agreement; Rights Obtained by Existing Member in Connection with Acquisition of Another Member's Interest; Judicial Dissolution

Achaian, Inc. v. Leemon Family LLC, 25 A.3d 800 (Del. Ch. 2011).

After dissension among the three members of a Delaware LLC arose, one of the members purported to transfer its entire 30% membership interest to a 20% member. Achaian, Inc. (“Achaian”) then filed this suit for judicial dissolution of the LLC claiming that there was a deadlock between Achaian and the remaining member, Leemon Family LLC (“Leemon”), which owned a 50% membership interest. Leemon claimed that the 30% member’s assignment of its membership interest to Achaian was only effective to give Achaian an additional 30% economic interest and that the LLC agreement required Leemon’s consent to admit Achaian as a member with respect to the newly acquired 30% interest. The court framed the question presented as follows: “may one member of a Delaware limited liability company assign its entire membership interest, including that interest’s voting rights, to another existing member, notwithstanding the fact that the limited liability company agreement requires the affirmative consent of all of the members upon the admission of a new member, or, must the existing member assignee be readmitted with respect to each additional interest it acquires after its initial admission as a member?” Reading the LLC agreement as a whole, the court concluded that it allowed an existing member to transfer its entire membership interest, including voting rights, to another existing member without obtaining the other member’s consent. The court reviewed the default provision of the Delaware LLC statute, which provides that an assignment of a limited liability company interest only entitles the assignee to economic rights and does not entitle the assignee to exercise the rights or powers of a member, but the court focused on the LLC agreement since it contained provisions addressing transfer of interest in the LLC. The court noted that the LLC agreement defined a member’s interest as “the entire ownership interest” of a member and that the agreement permitted a member to transfer “all or any portion of” its interest to any person at any time. The agreement also provided that no person shall be admitted as a member without the written consent of the members. Leemon argued that the agreement did not reverse the default rules under the Delaware LLC statute or that the LLC agreement unambiguously distinguished between the transferability of a member’s economic interest and voting rights. The court, however, agreed with Achaian that the agreement as a whole allowed the transfer of all of the rights accompanying an interest—including the voting rights—to an existing member without the written consent of the other members. The court concluded that the definition of a member’s interest as “the entire ownership interest” of the member was best read to include the voting rights of a member, especially in the context of other provisions of the agreement. The court concluded that the provision of the agreement requiring written consent of the members to admit any person as a member did not require a person who was already a member to be readmitted in order to acquire additional voting rights with the acquisition of additional interests in the LLC. Because Achaian was already admitted as a member at the time it acquired the additional interest, the court did not view the consent requirement as having any application. The court found nothing in “the LLC Act, the Uniform LLC Act, or learned commentaries and treatises on alternative entities suggesting that such a serial admission scheme is standard practice.”

Given that Achaian acquired the voting rights with respect to the 30% interest transferred to it, Achaian and Leemon held identical 50% interests, and the court found that Achaian had alleged the recognized three prerequisites for a judicial dissolution, analogizing (as it has on past occasions)

to the prerequisites for judicial dissolution of a joint venture corporation. First, Achaian and Leemon were coequal 50% owners with an equivalent corresponding 50% right to manage the LLC. Second, Achaian pled that the two members were engaged in a joint venture. Leemon's allegation that Achaian purchased the additional 30% interest in an effort to purchase a "phony deadlock" was not appropriate for consideration at the motion to dismiss stage. Finally, Achaian alleged that it and Leemon were unable to agree on the management of the LLC, and the LLC agreement did not provide a "reasonable exit mechanism" or other provision to break the deadlock. Thus, Achaian's pleadings were sufficient to give rise to the inference that the management of the LLC was deadlocked, and the court denied the motion to dismiss.

Inspection Rights

Sanders v. Ohmite Holding, LLC, 17 A.3d 1186 (Del. Ch. 2011).

The plaintiff, Sanders, sought books and records from a Delaware LLC pursuant to Section 18-305 of the Delaware Limited Liability Company Act. When the LLC was formed in 1998 in connection with a merger, Sanders lent \$2 million to one of the members and received a security interest in the member's units. The loan was partially repaid in 2000, and Sanders released his lien on half of the units held as collateral. In 2007, the member transferred his remaining units to Sanders, who believed and was told by the member that the units constituted 7.75% of the LLC. In 2008, Sanders learned that his interest was not the 7.75% stake that he believed he had, but rather a mere 0.000775%. Initially, the LLC refused to acknowledge that Sanders had become a member of the LLC. After initiating an action to obtain a declaratory judgment that he was a member of the LLC, the LLC conceded that Sanders was the owner of 7.75 units. In 2008, Sanders received a K-1 showing that he owned only a 0.000775 stake in the LLC. Sanders sought an explanation and received only a terse response from the LLC reporting that additional units had been issued to obtain additional capital before the transfer of the units to Sanders. Sanders sent the LLC a letter requesting books and records relating to the dilution of the interest he purchased. The letter requested books and records in several categories and stated that he sought the records to evaluate the value of his ownership interest, the status of the LLC's business and financial condition, the performance of the LLC's management, and the legitimacy of the dilution of his interest from 7.75% to 0.000775% of the LLC. The LLC denied the request on the basis that Sanders did not set forth any facts indicating why he needed to evaluate the matters specified and could not make any assertion that the dilution was illegitimate since he was not a member at the time of the transaction that caused the dilution. After Sanders filed this action, the LLC provided copies of tax returns and unaudited financial statements for the years 2007-2009. From these documents, Sanders could reasonably infer that the LLC issued units in a related-party transaction at a deep discount. Sanders thus questioned whether the LLC received proper consideration for the additional units issued and whether the LLC was being operated exclusively for the benefit of its principal owner rather than the members as a whole. Sanders requested books and records to answer those questions, and the LLC refused the request. The LLC agreement provided that a non-member assignee was not entitled to receive any information of LLC transactions or inspect the LLC's books. The LLC claimed that Sanders was not entitled to obtain any books and records from before the date in 2007 when he became a member. The court stated that the provision in the LLC agreement only limited the rights of an assignee. Sanders was not an assignee, but a member, and the LLC agreement did not limit the statutory

inspection rights of a member under the Delaware LLC statute. Looking to corporate law addressing the proper purpose requirement, the court concluded that Sanders had a proper purpose for his inspection request. The court rejected the LLC's argument that Sanders could not have a proper purpose for inspecting the books and records because he was not yet a member at the time of the events he sought to investigate. If the events he sought to investigate were "reasonably related" to his interest as a member, then he should be given access. Valuing his ownership and investigating potential wrongdoing are proper purposes. At this stage, Sanders only needed to have a credible basis to suspect wrongdoing, a standard the court said was readily met here. The court also concluded that the books and records sought were reasonably required to fulfill the stated proper purpose. Minutes of membership or management meetings relating to dilution, documents reflecting the number of units issued and consideration for the units, filings on Schedule K-1, and books and records about the opportunity of Sanders or his predecessor to buy units at the same price were all necessary to evaluate whether the dilution was wrongful. Financial reports and tax returns going back to 2003 were necessary to evaluate whether there were extenuating circumstances that required issuance of a large number of units for a deep discount. The court thus granted summary judgment in favor of Sanders.

Formation of LLC; Determination of Membership; Effect of Bankruptcy of Member

In re Williams (Spain v. Williams), 455 B.R. 485 (Bankr. E.D. Va. 2011).

The plaintiff, Spain, sought a winding up of an LLC in which she claimed to be a member. Spain claimed that she and Williams each owned a 50% interest in the LLC. Williams and his wife, Michele, claimed that Williams owned a 51% interest and that Sprouse owned the other 49% interest. The LLC was formed by filing articles of organization with the Virginia State Corporation Commission ("SCC"). The articles of organization listed Williams as the organizer and Sprouse as the registered agent. Sprouse was identified in the articles of organization as "a member or manager of the limited liability company." The LLC did not have an operating agreement. The LLC was in the construction business, and Sprouse acted as "Operations Manager" in submitting a subcontractor's bid on behalf of the LLC. A later modification of the subcontract was signed by both Sprouse and Williams on behalf of the LLC. Williams, Sprouse, Michele Williams, and Spain opened bank accounts on behalf of the LLC on which they were all signatories. A worker's compensation insurance agreement signed by Williams covered Sprouse and Williams as the officers of the LLC and identified Williams and Sprouse as each owning 50% of the LLC. Williams was identified as president and Sprouse as general manager of the LLC in a safety and health program document issued by the LLC as well as on business cards of the LLC. Spain issued a personal guaranty of the LLC's credit so that the LLC could rent two pieces of heavy equipment, and Spain allowed Sprouse to use her credit card to rent and purchase other tools and equipment needed by the LLC to perform its subcontract. Sprouse and Williams came to the job site daily, while Spain and Michele Williams were only present on some days. Spain and Michele Williams frequently wrote checks for payroll and other expenses. Spain wrote checks for the workers Sprouse supplied, and Michele Williams wrote checks for the workers Williams supplied. Sprouse and Williams kept separate work logs and stored their business documents in their respective homes. Essentially, Sprouse and Spain appeared to operate as one business and Williams and his wife as another, with each business using the LLC to secure construction work for their businesses. A couple months into

the project, Spain abruptly revoked her guaranty. Sprouse abandoned work at the job site, but Williams and his crew continued the work and completed the job. After the completion of that job, Williams performed other work on the same project under the LLC's name. The LLC was eventually canceled by the SCC for failure to pay its annual registration fee. In order to address the claim for winding up, the court had to determine which parties were members or interest holders of the LLC, the legitimate debts and obligations of the LLC, and how to wind up the LLC.

As the court began to undertake its analysis of which parties were members of the LLC, the court first made the point that the LLC was properly constituted as an LLC even though it was "dysfunctional" from its inception in that only the most minimal of formalities were observed. The court pointed out that the SCC issued a certificate of organization for the LLC, which the Virginia LLC statute provides is conclusive evidence that all conditions precedent required to be performed have been complied with and that the LLC has been formed under the statute. Further, the LLC was issued a taxpayer identification number and entered into contracts with third parties. Thus, the court concluded that the LLC was a valid LLC and that the court should not simply disregard its existence.

The court next examined the provisions of the Virginia Limited Liability Company Act bearing on the determination of an LLC's members and characterized the statute as providing "surprisingly little guidance." The court noted that Virginia law appears to require member-managed LLCs to have at least one member and specifies that an LLC is member-managed unless the articles of organization or an operating agreement provide that the LLC is manager-managed. The court concluded that the LLC in this case was member-managed because the articles of organization did not list any managers and the LLC did not have an operating agreement. The court reviewed the provisions of the Virginia LLC statute regarding determination of membership and found that the LLC did not comply with any of the provisions. The statute specifies that the articles of organization or operating agreement can define the membership of an LLC. Additionally, the statute provides several methods by which members may be admitted to an LLC. Persons acquiring a membership interest from the LLC itself become members upon compliance with the terms of the operating agreement or by a majority vote of the members in a member-managed LLC without an operating agreement. If an LLC had no members at its commencement, its membership can be determined by "any writing signed by both the initial member or members and the managers, if any are designated in the articles of organization, or, if no managers are so designated, the organizers." Since the court found none of these provisions were satisfied, the court turned to other evidence to determine the membership of the LLC.

Given the silence of the Virginia statute on "a method for determining members in a properly constituted limited liability company that does not adhere to any of the organizational formalities," the court looked to the acts and conduct of the parties to determine the membership of the LLC. The court found the cumulative evidence indicated that Williams and Sprouse were the two initial members of the LLC. The parties did not disagree that Williams was and always had been a member of the LLC, and the court stated that his status as organizer, though not conclusive, supported his membership. Williams signed numerous documents binding the LLC, filed tax returns for the LLC, held himself out as president, and incurred numerous expenses on the LLC's behalf. Williams insisted that he formed the LLC with Sprouse and that Sprouse was the other member, but Sprouse denied that he was a member and insisted that Spain was the other member. The court found that Sprouse rather than Spain was the other initial member based on the listing of Sprouse as registered agent in the articles of organization, Sprouse's filing of several forms with the SCC in which the

address of the registered office was changed and Sprouse was identified as the registered agent and a “member or manager of the limited liability company,” the listing of Sprouse as “Operations Manager” and a 50% owner of the LLC in the worker’s compensation insurance agreement, and Sprouse’s signature on bank account resolutions in the capacity as manager of the LLC. In addition to this documentary evidence of membership, Sprouse held himself out as the manager of the LLC on multiple occasions during the LLC’s early existence. The court stated that the only way Sprouse could have functioned as a manager in the absence of an operating agreement appointing him manager was as a member-manager. The court thus held that Williams and Sprouse were the initial members and that each held a 50% interest since the only written evidence of the amount of their ownership interests was the insurance agreement. Because Sprouse denied that he was a member and claimed that Spain was the other member, the court concluded that Spain must have acquired Sprouse’s interest in the LLC at some point. Spain behaved as if she were a member by providing her personal guaranty of the LLC’s rental of equipment and contributing other capital to the LLC while Sprouse invested no money in the LLC. Based on the statutory rules regarding assignment of a membership interest and admission of a member, the court concluded that Spain acquired Sprouse’s share of profits and losses of the LLC and the right to any distributions to which Sprouse would have been entitled, but Spain did not acquire all the rights of a member because Williams never voted to admit Spain as a member.

The court next discussed the obligations of the LLC and the claims of the interest holders. The court concluded that a default judgment taken by Sprouse against the LLC was not a valid debt of the LLC because Sprouse was both the plaintiff and registered agent of the defendant and obtained the judgment after service on himself without any other representatives of the LLC being made officially aware. The court found it unnecessary to parse voluminous exhibits presented by Williams and Spain documenting expenses incurred in funding the LLC because the court concluded the expenses should be considered capital contributions in the absence of formal debt instruments documenting the LLC’s liability or entries on the books and records of the LLC reflecting any indebtedness to the interest holders. The court characterized any differences between the precise amounts contributed by Williams and Spain as “relatively insignificant” and “irrelevant to the ultimate distribution” of the LLC’s funds. The court held that Williams and Spain, as 50% interest holders, were each entitled to an equal portion of the LLC’s remaining funds after payment of the valid debts.

With respect to the method of winding up the LLC, the court noted that the Virginia LLC statute provides that the members may wind up the affairs of the LLC. However, both Williams and Spain had filed bankruptcy cases under Chapter 13. The Virginia Limited Liability Company Act provides that a member is dissociated from the LLC upon becoming a debtor in bankruptcy and the former member continues to hold a membership interest with only the rights of an assignee. Pursuant to Section 541(c)(1)(B) of the Bankruptcy Code, the membership interests of Williams and Spain were vested in their respective bankruptcy estates. Because the Virginia LLC statute provides that a dissociated member has only the rights of an assignee, i.e., only the economic rights of the membership interest, there was no one remaining to wind up the affairs of the LLC and distribute its funds. Thus, the court appointed a liquidating trustee to wind up the LLC’s affairs. The court noted that it had authority to appoint a liquidating trustee because the proceeding was removed to the bankruptcy court from the circuit court on which such jurisdiction is conferred under the Virginia LLC statute.

Married Couple is Neither Individual nor Entity and Cannot be LLC Member

In re Chreky (Barrett v. Chreky), 450 B.R. 247 (D.D.C. 2011).

Under the terms of a District of Columbia LLC owned by Mr. and Mrs. Chreky, Mrs. Chreky alone was a 1% member, and Mr. and Mrs. Chreky were jointly a member with a 99% interest. The bankruptcy court held that a married couple can be a person or entity that is a member of an LLC, but a creditor of Mr. Chreky argued that a married couple must be considered two separate people. The district court agreed with the creditor and held that a married couple may not be a member of a D.C. LLC. Under the D.C. LLC statute, an LLC is defined in terms of having one or more members, and “member” is defined as a “person” that owns an interest in an LLC. A “person” is defined as a natural person over the age of 18 years, various specified entities, or “any other individual or entity in its own name or any representative capacity.” The court reviewed the treatment of a married couple under D.C. case law and legislation and explained that D.C. legislation has overruled the common-law concept of marital unity under which a couple was treated as one person. Because a married couple now consists of two people under D.C. law, the court held that a married couple is neither an individual nor an entity that can be a member in an LLC. The court went on to state, however, that a married person may hold his individual membership in the LLC as a tenancy by the entireties with his spouse because a membership interest is personal property. The district court remanded to the bankruptcy court for findings of who actually held the membership interest held in name by Mr. and Mrs. Chreky and for findings of whether that person held the membership interest as a tenant by the entireties.

Charging Order

Meyer v. Christie, No. 07-2230-CM, 2011 WL 4857905 (D. Kan. Oct. 13, 2011).

The defendants objected to a charging order obtained by the plaintiffs with respect to interests in Kansas LLCs. The defendants argued that the charging order may conflict with the terms of the LLCs’ operating agreements relating to assignability. The court acknowledged that an operating agreement may absolutely prohibit transfers or assignments, but the court stated that such prohibition cannot prevail over other applicable law. The court explained that the Kansas Revised Limited Liability Company Act contains a provision recognizing the charging order as a remedy by which a judgment creditor of a member can seek satisfaction by petitioning a court to charge the member’s LLC interest with the amount of the judgment, and the court noted that the statute makes clear that the charging order is the only remedy by which a judgment creditor of a member can reach the member’s interest in the LLC. The court further noted that the language of the LLC statute was taken from limited partnership law, and the court stated that the language “simply authorizes the charging order and states that the charging creditor has the rights of an assignee of the LLC interest.” The court then discussed the origin and effect of the charging order under the Uniform Partnership Act of 1914, explaining that the judgment creditor is entitled only to the debtor partner’s share of distributions and is not entitled to participate in the management of the partnership. While the court indicated it understood this approach to apply generally in the LLC context, the court pointed out the provision of the Kansas LLC statute that provides an assignee has the right to participate in the management of the business and affairs of the LLC as a member where the member is the sole

member of the LLC at the time of the assignment, and the court described this provision as applying to a judgment creditor with a charging order against the interest of a sole member.

American Institutional Partners, LLC v. Fairstar Resources Ltd., C.A. No. 10-489-LPS, 2011 WL 1230074 (D. Del. March 31, 2011).

This action was brought by judgment debtors whose interests in numerous entities, some of which were Delaware LLCs, were the subject of charging orders issued by a Utah court in which the judgment was entered. The Utah court ordered foreclosure of the charging orders by constable's sale and specified that the buyers would acquire all rights in a purchased company if a judgment debtor was the company's sole member. The Utah court rejected the judgment debtors' objections to the constable sales and determined that Utah law applied to all execution proceedings in the matter, including the foreclosure of a member's interest in a domestic or foreign LLC. The judgment debtors filed suit in the Delaware Chancery Court seeking a declaratory judgment that the foreclosures on membership interests in eight Delaware LLCs (the "Subject LLCs") were invalid under Delaware law as well as a declaration of the identity of the members and managers of the Subject LLCs. The judgment creditors removed the suit to federal court and sought dismissal of the claims or transfer of venue to Utah. The judgment creditors sought dismissal on the basis that the court lacked personal jurisdiction over them or on the grounds that the complaint failed to state a claim based on the doctrine of res judicata or the *Rooker-Feldman* doctrine.

The court analyzed the implied consent provision of the Delaware LLC statute and found that the exercise of jurisdiction over one of the judgment creditors was supported by the implied consent provision based on the judgment creditor's actions in connection with several of the Subject LLCs. The implied consent provision applies to a person who materially participates in the management of a Delaware LLC except that the power to select or participate in the selection of managers does not by itself constitute participation in the management of the LLC for these purposes. The judgment debtors' allegations that the judgment creditor asserted direct or indirect 100% ownership interests in three of the Subject LLCs and purported to appoint the sole managers of these LLCs along with allegations of certain actions taken or representations made on behalf of the LLCs in other state court and bankruptcy proceedings were sufficient to constitute "material participation" in the management of the LLCs for purposes of the implied consent statute. Further, by foreclosing on Delaware LLCs and taking ownership rights, the court concluded that the judgment creditor had purposefully availed itself of Delaware law and could not be surprised to be haled into a Delaware court for a dispute over the governance of the Delaware LLCs. Due process requirements were thus satisfied. With respect to the other judgment creditor, however, the court concluded that there was no basis for exercising personal jurisdiction because the only basis asserted by the judgment debtors for exercising jurisdiction was an unsubstantiated allegation that the second judgment creditor controlled the judgment creditor that was materially participating in the management of the Subject LLCs as described above.

With respect to the res judicata argument, the court found that the claims in the Utah and Delaware actions arose out of the same transaction (i.e., the constable sales of the Delaware LLCs), and the claims in the Delaware action were presented or should have been presented in the first suit in Utah. Thus, res judicata principles precluded assertion of the claims in the Delaware action if both cases involved the same parties or privies. The claims of the judgment debtors were barred because the judgment debtors were parties in the Utah action, but two additional plaintiffs in the Delaware

suit (Delaware LLCs which were the subject of foreclosure sales) were not parties in the Utah action, and the court held that their claims were not barred.

The court held that the *Rooker-Feldman* doctrine did not bar the claims because the plaintiffs raised issues not presented in the Utah action (i.e., that the judgment creditors could not gain managerial rights in the foreclosure sales even under Utah law and a challenge to the demand by the judgment creditors for documents of one of the Subject LLCs). The plaintiffs in the Delaware action sought a declaration of rights in the aftermath of the Utah rulings rather than a stay of the sales as sought in the Utah action, and the *Rooker-Feldman* doctrine is not a bar where additional claims are asserted in the federal forum even if the claims contradict a legal conclusion made by the state court.

The court denied the judgment creditors' request to transfer venue of the action to the District of Utah. Balancing the great weight given the plaintiffs' choice of forum against the origin of the claim in Utah, the court concluded that the latter factor did not outweigh the presumption that a case should be litigated in the forum chosen by the plaintiff.